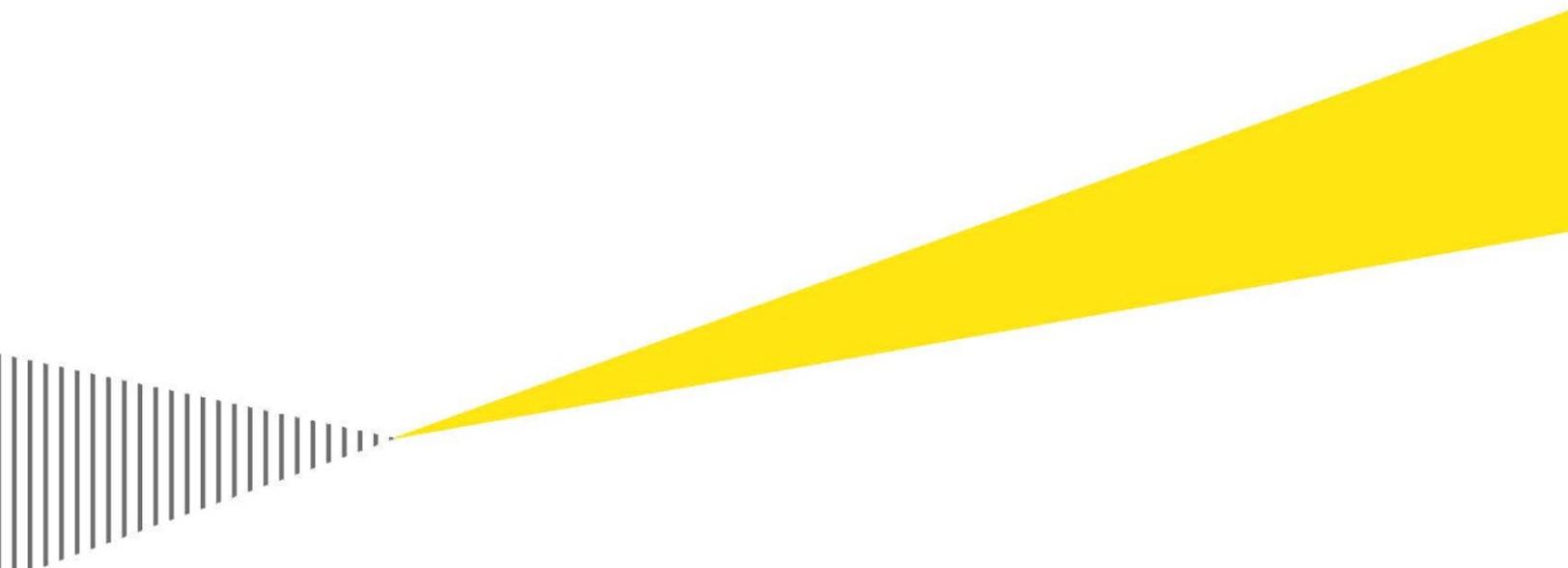


AUDITED FINANCIAL STATEMENTS

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP



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

Audited Financial Statements

Years Ended June 30, 2014 and 2013

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Ernst & Young LLP
Plaza 273, Suite 1000
273 Ponce de León Avenue
San Juan, PR 00917-1951

Tel: +1 787 759 8212
Fax: +1 787 753 0808
ey.com

Report of Independent Auditors

The Board of Directors
Puerto Rico Aqueduct and Sewer Authority

Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Aqueduct and Sewer Authority (a component unit of the Commonwealth of Puerto Rico) (the Authority), which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Aqueduct and Sewer Authority at June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Restatement of Prior Period Financial Statements

As more fully discussed in Note 21 to the financial statements, as of July 1, 2012, the net position for the Authority was restated to correct prior period misstatements related to the presentation of the capital assets and depreciation expense. Our opinion is not modified with respect to this matter.

Emphasis of a Matter

As more fully discussed in Note 11, the Authority's \$200 million notes payable with private financial institutions mature on May 29, 2015. The note discusses the Authority's current plans to address its liquidity situation, management's plan to collect funds, as well as consequences to the Authority if such plans are unable to be executed. There are no assurances that management's plans will be sufficient to avoid defaulting on its debts. Our opinion is not modified with respect to this matter.

Adoption of GASB Statement No. 65, Items Previously Reported as Assets and Liabilities

As discussed in Note 1 and Note 21 to the financial statements, the Authority changed its method for accounting for bond issue costs and deferred losses related to bond refundings as a result of the adoption of GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, effective October 1, 2012. Our opinion is not modified with respect to this matter.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4 through 25 and the schedule of funding progress on page 86 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2015, on our consideration of the Puerto Rico Aqueduct and Sewer Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Ernst + Young LLP

March 31, 2015

Stamp No. E158135
affixed to
original of
this report.

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

Unaudited Management's Discussion and Analysis

Year Ended June 30, 2014

As management of Puerto Rico Aqueduct and Sewer Authority (the Authority), we offer readers of the Authority's annual financial report our discussion and analysis of the Authority's financial performance during the fiscal years ended on June 30, 2014, 2013 and 2012. Please read it in conjunction with the Authority's financial statements, which follow this section. Numbers included are not rounded to facilitate the readers' analysis.

June 30, 2014 and 2013 Financial Highlights

- The Authority's net position decreased by \$41.0 million to \$2,378.9 million, or 1.7%, which represents an increase of \$430.1 million when compared to the 2013 decrease in net position on of \$471.1 million as restated. The increase was primarily as the net result of an increase in operating revenues of \$391.7 million, a decrease of total operating expenses, including depreciation and amortization of \$55.4 million, an increase in net nonoperating expenses of \$22.8 million, and an increase in capital contributions of \$5.7 million.
- Operating revenues increased by \$391.7 million to \$1,127.4 million, or 53.2%, mainly due to the impact of the implementation of a new rate structure in July 15, 2013.
- Operating expenses, including depreciation and amortization, decreased by \$55.4 million to \$984.6 million, or 5.3%, primarily as a result of a decrease in the cost of assets disposition of \$85.3 million, a decrease in electricity expenses of \$42.4 million, a decrease in Superaqueduct service contract expense of \$1.7 million and netted by an increase other operating expense of \$34.5 million, an increase in payroll and related expenses of \$19.5 million, an increase in depreciation and amortization expense of \$14.1 million, and an increase in material and replacements expense of \$5.3 million.
- Non operating expenses increased by \$22.8 million to a net expense of \$209.7 million, primarily as a result of an increase of \$18.7 million in interest expense, net of amortization of bond premium and discount, and deferred refunding losses, a decrease of \$3.0 million in interest income, and a decrease of \$1.1 million in other income.
- Capital contributions increased by \$5.7 million to \$25.9 million, primarily as a result of an increase of \$1.8 million for both, the Rural Development contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, and an increase in other contributions of \$2.4 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

June 30, 2014 and 2013 Financial Highlights (continued)

- Total assets increased by \$118.7 million to \$8,268.3 million or 1.4%, primarily due to an increase in current assets of \$39.8 million, a decrease in restricted assets of \$22.8 million, an increase in Authority's capital assets net of depreciation and amortization of \$105.4 million and a decrease of \$3.7 million in deferred outflow of resources on debt refunding loss as result of the adoption of the GASB 65. Total liabilities increased by \$159.7 million to \$5,889.3 million or 2.7%, primarily as a result of an increase of \$190.6 million in long term debt, an increase of \$35.7 million in accrued liabilities, an increase of \$3.0 million in accrued interest, and a decrease in lines of credit of \$81.5 million.

June 30, 2013 and 2012 Financial Highlights

- The Net position at the beginning of the fiscal year 2013 was restated from \$2,998.9 million to \$2,891.2 million as a result of the implementation of GASB Statement No.65 "Items Previously Reported as Asset and Liabilities" (GASB 65), which requires recording the deferred debt issuance costs previously presented as Other Assets, as operating expenses. Starting on fiscal year 2014 all non-insurance related debt issuance costs will be presented as expense during the year they are incurred. In addition, capital assets being depreciated were understated by \$274.1 million related to construction projects completed in prior years that were not being depreciated. For additional detail information, refer to note 21.
- The Authority's net position as restated decreased by \$471.2 million to \$2,420.0 million, or 16.2%, which represents a decrease of \$530.4 million when compared to the 2012 increase in net position on of \$59.1 million. The decrease was primarily the net effect of the implementation of the GASB 65 of \$63.3 million, a decrease in operating revenues of \$77.4 million, an increase of total operating expenses, including depreciation and amortization of \$84.9 million, an increase in nonoperating expenses of \$336.0 million and a decrease in capital contributions of \$31.9 million.
- Operating revenues decreased by \$77.4 million to \$735.6 million, or 9.5%, mainly due to a decrease of \$70.2 million from appropriations from the Central Government and an increase in the provision for bad debts of \$8.0 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

June 30, 2013 and 2012 Financial Highlights (continued)

- Operating expenses, including depreciation and amortization, increased by \$84.9 million to \$1,040.1 million, or 8.8%, primarily as a result of an increase in chemical expenses of \$6.7 million, a decrease in payroll and related expenses of \$3.5 million, a decrease of other operating expense of \$2.4 million, a decrease in repairs and maintenance expense of \$3.4 million and the net effect of an increase in electricity expense of \$8.9 million, an increase in depreciation and amortization expense of \$28.3 million, and an increase of cost of asset disposition of \$63.8 million.
- Nonoperating revenues and (expenses) decreased by \$336.0 million to a net expense of \$186.9 million, primarily as a result of a reduction of \$304 million in Commonwealth contributions of debt refunding on PFC bonds occurred during fiscal year ended June 30, 2012, an increase of \$39.3 million in interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding losses, an increase of \$5.9 million of Commonwealth contributions for payment of interest on PFC bonds, and an increase of \$2.8 million in interest income.
- Capital contributions decreased by \$31.9 million to \$20.1 million, primarily as a result of a decrease of \$12.7 million in federal grants received from Rural Development, a decrease of \$13.6 million of American Recovery and Reinvestment Act funds and a decrease of \$5.7 million from Federal Emergency Management Agency.
- Total asset as restated decreased by \$383.2 million to \$8,149.6 million or 4.4%, primarily due to an increase in current assets of \$9.1 million, a decrease in restricted assets of \$437.9 million, an increase in Authority's capital assets net of depreciation and amortization of \$49.1 million, and the reduction of \$39.3 million in deferred outflows of resources (from debt refunding loss), which were previously recorded as other assets and reducing by \$63.3 million the deferred issuance cost, which were expensed as a result of the implementation of GASB 65. Total liabilities, restated, increased by \$87.9 million to \$5,729.5 million or 1.5%, primarily as a result of a net increase of \$47.8 million in accounts payable and accrued liabilities, an increase in long term debt of \$23.7 million, including the impact of GASB 65 in the net position and an increase in other liabilities of \$16.4 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Overview of the Financial Statements

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

Financial Analysis of the Authority

The balance sheets and the statement of revenues, expenses, and changes in net position, reports 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.

As discussed in detail in Note 21 – “Adoption of GASB No. 65 and Prior Period Restatement”, during fiscal year ended June 30, 2014, GASB No.65, Items Previously Reported as Asset and Liabilities, became effective, which requires recording the non-insurance portion of deferred debt issuance costs previously presented as Other Assets in the Authority's balance sheets, as operating expenses, and proper classification of certain items previously reported as assets or liabilities as deferred outflows of resources and deferred inflows of resources. As a result of the implementation of GASB 65, starting with the 2014 fiscal year, all debt issuance costs will be presented as expense during the year they are incurred. Also, during the course of preparing the 2014 financial statements, the Authority noted an understatement on capital assets being depreciated and overstatement on prior year net position due to unclosed construction in progress. As consequence, \$274.1 million in a correcting entry was made in the 2013 prior period financial statements to transfer capital assets from construction in progress to capital assets being depreciated. As part of the prior year adjustment, a \$56.1 million restatement was recorded related to depreciation expense.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Analysis of Financial Results

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

	June 30		Change
	2014	2013 <i>(As restated)</i>	
Current and other assets	\$ 798,555	\$ 785,255	\$ 13,300
Capital assets, net	7,469,758	7,364,353	105,405
Total assets	8,268,313	8,149,608	118,705
Long-term debt outstanding	5,312,311	5,121,646	190,665
Other liabilities	577,023	607,937	(30,914)
Total liabilities	5,889,334	5,729,583	159,751
Net position:			
Net investment in capital assets	2,525,360	2,689,467	(164,107)
Restricted	27,050	82,760	(55,710)
Unrestricted deficit	(173,431)	(352,202)	178,771
Total net position	\$ 2,378,979	\$ 2,420,025	\$ (41,046)

	June 30		Change
	2013	2012 <i>(As restated)</i>	
Current and other assets	\$ 785,255	\$ 1,217,598	\$ (432,343)
Capital assets, net	7,364,353	7,315,230	49,123
Total assets	8,149,608	8,532,828	(383,220)
Long-term debt outstanding	5,121,646	5,097,937	23,709
Other liabilities	607,937	543,675	64,262
Total liabilities	5,729,583	5,641,612	87,971
Net position:			
Net investment in capital assets	2,689,467	3,119,172	(429,705)
Restricted	82,760	26,186	56,574
Unrestricted deficit	(352,202)	(254,142)	(98,060)
Total net position	\$ 2,420,025	\$ 2,891,216	\$ (471,191)

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Net Position

June 30, 2014 and 2013

The Authority's net position as of June 30, 2014 was approximately \$2,378.9 million. This is an increase of \$41.0 million from the restated net position as of June 30, 2013 of \$2,420 million.

Total assets increased by \$118.7 million during the fiscal year ended June 30, 2014.

Capital assets increased by \$105.4 million due to net current year additions of \$375.0 million offset by current year depreciation and amortization including retirements of \$269.9 million.

Current and other assets increased by \$13.3 million, primarily a net effect of an increase in accounts receivable of \$85.9 million, an increase of \$4.9 million in material and supplies inventory, a decrease of \$56.5 million in cash and cash equivalents, a decrease in accounts receivables from Commonwealth of \$17.0 million and a \$3.7 million decrease in deferred outflows of resources.

Restricted cash and unrestricted cash and cash equivalents as of June 30, 2014, decreased by \$56.5 million when compared with June 30, 2013. The decrease is primarily due to usage of 2013 surplus funds for debt service payments.

Total liabilities increased by \$159.7 million to \$5,889.3 million, or 2.7%. Total current liabilities increased by \$129.1 million mainly as a result of the net effect of an increase in the current portion of long term debt of \$163.6 million as a result of the issuance of \$200 million note payable with commercial banks, an increase in accrued liabilities of \$35.7 million, an increase in accrued interest of \$3 million and a decrease of \$73.6 million in account payable.

Total non-current liabilities increased by \$30.7 million, primarily as a result of the net effect of an increase of \$77.6 million of the noncurrent portion in notes payables which includes the outstanding balance of \$72.3 million of the \$150 million line of credit with GDB that was refinanced into an interim loan note payable agreement, the balance outstanding of \$8.2 million in the \$70 million lines of credit with the GDB and the proceeds and payments of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, an increase in compensated absence and postemployment benefits of \$3.3 million, the decrease of \$53.1 million on bonds payable as results of the

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Net Position (continued)

June 30, 2014 and 2013 (continued)

payments of principal on outstanding bonds, the payment of \$31 million on 2012 Series B bonds reclassified to current portion, and the implementation of the GASB 65 for the earliest comparative period presented, which requires, the deferred losses from refunding debt to be presented as a deferred outflow of resources instead of a reduction of the outstanding principal balance of long-term debt.

June 30, 2013 and 2012

The net position at the beginning of the fiscal year 2013 was restated from \$2,998.9 million to \$2,891.2 million as a result of a restatement. For additional details, refer to note 21.

The Authority's net position as of June 30, 2013 was approximately \$2,420.0 million. This is a decrease of \$477.1 million from the net position as of June 30, 2012 of \$2,891.2 million.

Total assets decreased by \$383.2 million during the fiscal year ended June 30, 2013.

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

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

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Net Position (continued)

June 30, 2013 and 2012 (continued)

Capital assets increased by \$49.1 million due to net current year additions of \$372.6 million offset by current year depreciation and amortization including retirements of \$341.2 million.

Total liabilities increased by \$87.9 million to \$5,729.5 million, or 1.5%. Total current liabilities increased by \$154.3 million mainly as a result of an increase \$47.8 million in accounts payable and accrued liabilities, an increase in the current portion of long term debt of \$94.3 million, and an increase of \$14.3 million in accrued interest.

Total non-current liabilities, as restated, decreased by \$66.3 million, primarily as a result of the effect of the reclassification of the deferred debt refunding losses to deferred outflows of resources as result of the implementation of GASB Statement No.65, the net effect of the reclassification of the lines of credit from noncurrent liabilities to current liabilities of \$89.8 million, an increase in bonds payable of \$19.4 million as a net result of the issuance of the Series II Rural Development Bonds of \$45.5 million, the payment of principal on 2008 Series A and B Revenue Bonds of \$13.0 million the payment of principal on Rural Development Bonds of \$9.0 million, an amortization of bonds premiums, discounts, and an increase in notes payable of \$19.7 million due to the net effect of borrowings and payments of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Capital Assets

Capital assets as of June 30, 2014 and 2013 were as follows (in thousands):

	June 30		Change
	2014	2013	
		<i>(As restated)</i>	
Capital assets being depreciated	\$ 10,302,793	\$ 9,773,405	\$ 529,388
Accumulated depreciation and amortization	(3,555,042)	(3,302,411)	(252,631)
	6,747,751	6,470,994	276,757
Land and other nondepreciable assets	72,996	71,188	1,808
Construction in progress	649,011	822,171	(173,160)
Capital assets, net	\$ 7,469,758	\$ 7,364,353	\$ 105,405

	June 30		Change
	2013	2012	
		<i>(As restated)</i>	
Capital assets being depreciated	\$ 9,773,405	\$ 8,843,253	\$ 930,152
Accumulated depreciation and amortization	(3,302,411)	(3,080,223)	(222,188)
	6,470,994	5,763,030	707,964
Land and other nondepreciable assets	71,188	69,931	1,257
Construction in progress	822,171	1,482,269	(660,098)
Capital assets, net	\$ 7,364,353	\$ 7,315,230	\$ 49,123

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Capital Assets (continued)

June 30, 2014 and 2013

The net increase of \$105.4 million in capital assets, as restated, includes additions of \$375.8 million, reduced by \$258.8 million in depreciation and amortization and \$11.1 million in net retirements. The \$375.1 million in capital investment is broken down as follows:

- \$326.6 million in the Authority's capital improvement program;
- \$48.4 million in renewal and replacement projects;

The Authority has approximately \$649.0 million in construction in progress as of June 30, 2014, and has construction commitments of approximately \$124.2 million.

June 30, 2013 and 2012

The net increase of \$49.1 million in capital assets, as restated, includes additions of \$372.6 million, reduced by \$244.7 million in depreciation and amortization and \$96.5 million in net retirements. The \$372.6 million in capital investment is broken down as follows:

- \$322.0 million in the Authority's capital improvement program;
- \$50.6 million in renewal and replacement projects;

The Authority has approximately \$822.1 million in construction in progress as of June 30, 2013, and has construction commitments of approximately \$88.3 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration

Long-term debt for the years ended June 30, 2014 and 2013 (as restated) was as follows (in thousands):

	June 30		Change
	2014	2013 <i>(As restated)</i>	
Bonds payable:			
2011 Series A PFC Commonwealth Appropriation Bonds	\$ 90,099	\$ 90,099	\$ -
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	102,183	-
2011 Series B PFC Commonwealth Appropriation Bonds (SA)	162,700	162,700	-
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	56,247	-
Revenue Bonds:			
2008 Series A Serial Bonds	67,960	80,865	(12,905)
2008 Series A Convertible Capital Appreciation Bonds	155,975	155,975	-
2008 Series A Term Bonds	1,095,125	1,095,125	-
2008 Series B Serial Bonds	22,445	22,445	-
2008 Series A and B Revenue Refunding Term Bonds	284,755	284,755	-
2012 Series A Serial Bonds	418,455	418,455	-
2012 Series A Term Bonds	1,381,995	1,381,995	-
2012 Series B Serial Bonds	188,130	188,130	-
2012 Series B Term Bonds	107,115	107,115	-
Rural Development Serial Bonds	397,000	405,064	(8,064)
Add premium on bonds refunding	26,817	27,302	(485)
Less :			
Bond discount	(16,217)	(16,386)	169
Total bonds	<u>\$ 4,540,784</u>	<u>\$ 4,562,069</u>	<u>\$ (21,285)</u>

(Continued)

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration (continued)

	June 30		Change
	2014	2013 <i>(As restated)</i>	
Bonds payable	\$ 4,540,784	\$ 4,562,069	\$ (21,285)
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	490,915	469,743	21,172
Notes with GDB	72,363	–	72,363
Notes with commercial banks	200,000	–	200,000
Total notes	<u>763,278</u>	<u>469,743</u>	<u>293,535</u>
Lines of credit	<u>8,249</u>	<u>89,835</u>	<u>(81,586)</u>
Long-term debt outstanding	<u>5,312,311</u>	<u>5,121,647</u>	<u>190,664</u>
Other long term liabilities:			
Accrued compensated absences	41,707	43,136	(1,429)
Net OPEB obligation	32,312	28,141	4,171
Early retirement obligation	–	93	(93)
Customer deposits	83,154	82,247	907
Total other liabilities	<u>157,173</u>	<u>153,617</u>	<u>3,556</u>
Total – long-term obligations	<u>5,469,484</u>	<u>5,275,264</u>	<u>194,220</u>
Current portion	<u>317,503</u>	<u>153,939</u>	<u>163,564</u>
Long-term obligations, less current portion	<u>\$ 5,151,981</u>	<u>\$ 5,121,325</u>	<u>\$ 30,656</u>

The Authority's long-term debt increased by \$190.6 million from \$5,121.6 million as of June 30, 2013 (as restated), to \$5,312.3 million as of June 30, 2014.

Bonds Payable

Bonds outstanding as of June 30, 2014 decreased by \$21.2 million, mainly from the payment of principal on 2008 Series A and B Revenue Bonds of \$12.9 million, and the payment of \$8.0 million in principal on Rural Development Bonds. During fiscal year 2014, the Authority did not issued additional bond debt.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration (continued)

June 30, 2014

Notes Payable

As authorized by the Authority's Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the Credit Agreement), as amended on February 26, 2014, with the Lenders party thereto and Oriental Bank, a financial institution organized under the laws of the Commonwealth as Administrative Agent for the Lenders, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to \$350 million to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust. This note had an outstanding balance of \$200 million as of June 30, 2014 and was designated by the Authority as Senior Indebtedness pursuant to the terms of the Master Agreement of Trust. On March 4, 2015, the Authority executed an amendment to the Credit Agreement originally executed on October 24, 2013, by and among PRASA, Oriental Bank as Administrative Agent and Banco Popular de Puerto Rico (BPPR) as a Lender. With the execution of this amendment, the local commercial bank syndicate agreed to extend the maturity date on the credit facility granted under the Credit Agreement through May 29, 2015. As a condition to such extension, PRASA agreed to make a principal payment in an aggregate amount of \$50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders \$40 million, reducing the outstanding principal amount of the indebtedness to \$160 million, and agreed to make two additional \$5 million principal payments on April 1, 2015 and May 1, 2015. The Authority does not currently have sufficient funds available to fully repay on May 29, 2015, the amount that will be outstanding on that date of \$150 million and is working on a bond issuance scheduled, to be closed prior to the note payable extended due date, to provide funds to cancel the outstanding balance at the date of the transaction, and to finance capital improvement projects. Management has alternative plans to repay the outstanding note payable balance by its due date if the bond issuance is not closed. However, there can be no assurance the projected bond issuance will be closed by the planned date and/or amount, or that management's alternative ways to repay the note or extend its due date will be achieved, such that a default on the note or other obligations that have cross default provisions will be avoided.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration (continued)

June 30, 2014 (continued)

Notes Payable (continued)

The Authority finances the cost of design and construction of certain capital improvements projects with notes from the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund programs that bear interest at 2%. As of June 30, 2014, the Authority's loans outstanding under these programs amounted to approximately \$490.9 million. These loans increased by \$21.1 million due to the net effect of drawings of \$41.5 million for payment of capital improvements projects and payments of principal outstanding of \$20.4 million.

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

Lines of Credit

The existing \$70.0 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2014 of approximately \$8.2 million.

The \$180.0 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2014.

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

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration (continued)

June 30, 2013

Bonds Payable

Bonds outstanding as of June 30, 2013 as restated after the adoption of the GASB 65, which requires to present the deferred losses from refunding debt by \$39.3 million as deferred outflows of resources. Bonds payable increased by \$66.1 million from the net effect of issuance of \$45.6 principal amounts of new bonds, the payment of principal on outstanding bonds of approximately \$21.3 million, the effect of the restatement of \$39.3 million from GASB Statement No.65, the series II bonds issued during fiscal year 2013 include \$45.6 million of Rural Development Serial Bonds for the purpose of paying interim lines of credit with GDB and establish a construction fund to complete ongoing capital projects.

Notes Payable

The Authority finances the cost of design and construction of certain capital improvements projects with notes from the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund programs that bear interest at 2%. As of June 30, 2013, the Authority's loans outstanding under these programs amounted to approximately \$470.0 million. These loans increased by \$19.7 million due to the net effect of drawings of \$39.3 million for payment of capital improvements projects and payment of principal outstanding of \$19.7 million.

Lines of Credit

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

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Debt Administration (continued)

June 30, 2013 (continued)

Lines of Credit (continued)

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

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

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

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

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, 2014 and June 30, 2013, as restated (in thousands):

	Years Ended June 30		Change
	2014	2013	
		<i>(As restated)</i>	
Operating revenue:			
Revenues from water and sewer services, net	\$ 1,127,422	\$ 735,693	\$ 391,729
Total operating revenues	1,127,422	735,693	391,729
Operating expenses:			
Payroll and payroll related expenses	291,639	272,092	19,547
Service contract – Superaqueduct	3,908	5,679	(1,771)
Professional and consulting services	32,371	31,575	796
Chemicals	28,659	28,872	(213)
Materials and replacements	18,085	12,731	5,354
Repairs and maintenance of capital assets	45,134	45,214	(80)
Electricity	166,720	209,168	(42,448)
Insurance	9,492	9,493	(1)
Other operating expenses	118,614	84,046	34,568
Operating expenses (excluding depreciation and amortization)	714,622	698,870	15,752
Depreciation and amortization	258,850	244,734	14,116
Cost of assets disposed of	11,143	96,508	(85,365)
Total operating expenses	984,615	1,040,112	(55,497)
Operating income (loss)	142,807	(304,419)	447,226
Nonoperating expenses, net	(209,759)	(186,907)	(22,852)
Loss before capital contributions	(66,952)	(491,326)	424,374
Capital contributions	25,906	20,135	5,771
Change in net position	(41,046)	(471,191)	430,145
Net position at beginning of year, <i>as restated</i>	2,420,025	2,891,216	(471,191)
Net position at end of year	\$ 2,378,979	\$ 2,420,025	\$ (41,046)

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

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

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

	Years Ended June 30		Change
	2013	2012	
	<i>(As restated)</i>		
Operating revenue:			
Revenues from water and sewer services, net	\$ 735,693	\$ 742,891	\$ (7,198)
Central Government appropriations	—	70,264	(70,264)
Total operating revenues	<u>735,693</u>	<u>813,155</u>	<u>(77,462)</u>
Operating expenses:			
Payroll and payroll related expenses	272,092	275,613	(3,521)
Service contract – Superaqueduct	5,679	5,813	(134)
Professional and consulting services	31,575	31,707	(132)
Chemicals	28,872	35,577	(6,705)
Materials and replacements	12,731	12,387	344
Repairs and maintenance of capital assets	45,214	48,668	(3,454)
Electricity	209,168	200,195	8,973
Insurance	9,493	9,687	(194)
Other operating expenses	<u>84,046</u>	<u>86,516</u>	<u>(2,470)</u>
Operating expenses (excluding depreciation and amortization)	698,870	706,163	(7,293)
Depreciation and amortization	244,734	216,383	28,351
Cost of assets disposed of	<u>96,508</u>	<u>32,631</u>	<u>63,877</u>
Total operating expenses	<u>1,040,112</u>	<u>955,177</u>	<u>84,935</u>
Operating loss	(304,419)	(142,022)	(162,397)
Nonoperating (expenses) revenues, net	<u>(186,907)</u>	<u>149,173</u>	<u>(336,080)</u>
(Loss) Income before capital contributions	(491,326)	7,151	(498,477)
Capital contributions	<u>20,135</u>	<u>52,096</u>	<u>(31,961)</u>
Change in net position	(471,191)	59,247	(530,438)
Net position at beginning of year, <i>as restated</i>	<u>2,891,216</u>	<u>2,831,969</u>	<u>59,247</u>
Net position at end of year, <i>as restated</i>	<u>\$ 2,420,025</u>	<u>\$ 2,891,216</u>	<u>\$ (471,191)</u>

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

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

June 30, 2014 and 2013

Net position decreased by \$41.0 million, from \$2,420 million in 2013, as restated, to \$2,378.9 million in 2014, due to the results of current year operations.

Major fluctuations that resulted in a decrease in net position of \$41.0 million when compared to 2013 operational results, as restated, are broken down as follows (in thousands):

Increase in operating revenues	\$ 391,729
Decrease in operating expenses	55,497
Increase in nonoperating revenues (expenses), net	(22,852)
Increase in capital contributions	5,771
Other changes	(471,191)
Net change	<u>\$ (41,046)</u>

Operating revenues increased by \$391.7 million for fiscal year ended June 30, 2014 when compared to fiscal year ended June 30, 2013. The increase is mainly due to the impact of the implementation of a new rate structure in July 15, 2013.

Operating expenses decreased by \$55.4 million primarily due to the net effect of the following:

- A decrease of \$85.3 million in cost of assets disposition.
- A decrease of \$42.4 million in electricity expenses.
- A decrease of \$1.7 million in service contract – Superaqueduct.
- An increase of \$34.5 million in other operating expenses.
- An increase of \$19.5 million in payroll and payroll related expenses.
- An increase of \$14.1 million in depreciation and amortization expense.
- An increase of \$5.3 million in materials and replacements expenses.

Nonoperating expenses increased by \$22.8 million when compared with previous fiscal year. This is mainly due to the increased of the debt interest payments and the amortization of bond premium and discount, and deferred refunding losses by \$17.9 million. Interest income decrease by \$3.0 million, and other income decreased by \$1.1 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

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

June 30, 2014 and 2013 (continued)

Capital contributions increased by \$5.7 million, primarily due to an increase of \$1.8 from both the Rural Development contributions and grants received from The Water Pollution Control Revolving Fund and Puerto Rico Safe Drinking Water Treatment Revolving Fund and, an increase in other contributions of \$2.4 million.

June 30, 2013 and 2012

The net position at the beginning of the fiscal year 2013 was restated from \$2,998.9 million to \$2,891.2 million. For additional details about the restatement, refer to note 21.

Net position decreased by \$471.1 million, from \$2,891.2 million in 2012, as restated, to \$2,420.0 million in 2013, due to operating results, as restated.

Major fluctuations that resulted in a decrease in net position of \$471.1 million when compared to 2012 operational results are broken down as follows (in thousands):

Decrease in operating revenues	\$ (77,462)
Increase in operating expenses	(84,935)
Increase in nonoperating revenues (expenses), net	(336,080)
Decrease in capital contributions	(31,961)
Other changes	59,247
Net change	<u><u>\$ (471,191)</u></u>

Operating revenues decreased by \$77.4 million for fiscal year ended June 30, 2013 when compared to fiscal year ended June 30, 2012. The decrease is mainly due to a decrease of \$70.2 million from appropriations received from the Commonwealth, and an increase in the provision for bad debt of \$8.0 million.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

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

June 30, 2013 and 2012 (continued)

Operating expenses increased by \$84.9 million primarily due to the net effect of the following:

- An increase of \$63.8 million in cost of assets disposition.
- An increase of \$28.3 million in depreciation and amortization expense.
- An increase of \$8.9 million in electricity expenses.
- A decrease of \$6.7 million in chemical expenses.
- A decrease of \$3.5 million in payroll and payroll related expenses.
- A decrease of \$3.4 million in repairs and maintenance of capital assets expense.
- A decrease of \$2.4 million in other operating expenses.

Nonoperating revenues (expenses) decreased by \$336.0 million when compared with previous fiscal year. This is primarily the net effect of a reduction of \$304.0 million in Commonwealth contributions as a result of debt refunding on PFC bonds during fiscal year ended June 30, 2012. Interest expense, bond premium and discount, and deferred refunding losses increased by \$39.3 million. Commonwealth contributions for payments of interest on PFC Bonds increased by \$5.9 million and, interest income increased by \$2.8 million.

Capital contributions decreased by \$31.9 million, primarily due to a decrease in Rural Development contributions of \$12.7 million, a decrease of \$13.6 of American Recovery & Reinvestment Act and, a decrease in other contributions of \$5.7 million.

Economic Factors, Ratings and Next Year's Budgets

The Puerto Rico Planning Board's reports on the performance of the Puerto Rico economy for fiscal year 2013 indicate that real gross domestic product increased by 0.3% over fiscal year 2012. The gross national product was \$70.7 billion in fiscal year 2013, an increase of 3.0% over fiscal year 2012. The projections for Puerto Rico's real gross national product are estimated at \$6.5 billion for fiscal year 2014, this represent a decrease of 0.2% over fiscal year 2013. At current prices, the gross national product is projected at \$72.3 billion and \$73.5 billion for fiscal years 2014 and 2015, respectively. This represent a growth of 2.3% for fiscal year 2014 and 1.6% in 2015. Real personal income in fiscal year 2013 increased by 1.4% over fiscal year 2012, for a total of \$10.16, the projections for fiscal year 2014 estimate at \$10.15 billion and in fiscal year 2015 at \$10.13, a decline of 0.1% and 0.2%, respectively; and personal income per capita increased from \$16,956 in fiscal year 2012 to \$17,413 in fiscal year 2013.

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

Unaudited Management's Discussion and Analysis (continued)

Year Ended June 30, 2014

Economic Factors, Ratings and Next Year's Budgets (continued)

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2014 averaged 1,006,646, decrease of 2.2%, compared to the previous fiscal year; and the unemployment rate averaged 14.3%.

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

On June 18 2014, the Authority adopted a balanced operational budget for fiscal year 2015, which included additional revenues from the rate increase. In addition, the Authority's Capital Improvement Program for the fiscal year 2015 is estimated in approximately \$430.0 million.

The credit rating of the Commonwealth and most of its public entities (including the Authority) were recently downgraded. The Authority's credit ratings are "Caa1" by Moody's Investor Services, "B" by Standard and Poor's Ratings Services and "B" by Fitch Ratings.

Contacting the Authority's Financial Management

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

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

Balance Sheets
(In thousands)

	June 30	
	2014	2013
	<i>(as restated)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 67,982	\$ 101,680
Accounts receivable, net	244,182	158,218
Receivables from federal agencies	3,326	2,702
Receivables from Commonwealth	16,806	33,837
Materials and supplies inventory, net	30,215	25,284
Prepayments and other current assets	5,483	6,377
Total current assets	367,994	328,098
Restricted assets:		
Restricted cash and cash equivalents	394,963	417,814
Capital assets:		
Capital assets being depreciated	10,302,793	9,773,405
Accumulated depreciation and amortization	(3,555,042)	(3,302,411)
	6,747,751	6,470,994
Land and other nondepreciable assets	72,996	71,188
Construction in progress	649,011	822,171
Total capital assets, net	7,469,758	7,364,353
Deferred outflows of resources:		
Deferred loss resulting from debt refunding	35,598	39,343
Total assets and deferred outflows of resources	\$ 8,268,313	\$ 8,149,608

(Continued)

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

Balance Sheets (continued)
(In thousands)

	June 30	
	2014	2013
	<i>(as restated)</i>	
Liabilities and net position		
Liabilities:		
Current liabilities:		
Bonds payable	\$ 49,077	\$ 17,216
Notes payable	241,570	19,605
Lines of credit	—	89,835
Accounts payable	142,845	216,517
Accrued liabilities	152,475	116,702
Accrued interest	105,947	102,922
Unearned revenue	18,583	18,178
Customers' deposits	6,846	6,584
Compensated absences and postemployment benefits	20,010	20,699
Total current liabilities	737,353	608,258
Noncurrent liabilities:		
Bonds payable	4,491,707	4,544,853
Notes payable	521,708	450,138
Lines of credit	8,249	—
Customers' deposits	76,308	75,663
Compensated absences and postemployment benefits	54,009	50,671
Total noncurrent liabilities	5,151,981	5,121,325
Total liabilities	5,889,334	5,729,583
Net position:		
Net investment in capital assets	2,525,360	2,689,467
Restricted for environmental compliance, capital activity and other	27,050	82,760
Unrestricted (deficit)	(173,431)	(352,202)
Total net position	2,378,979	2,420,025
Total liabilities and net position	\$ 8,268,313	\$ 8,149,608

See accompanying notes.

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

Statements of Revenues, Expenses and Changes in Net Position
(In thousands)

	Year Ended June 30	
	2014	2013
	<i>(as restated)</i>	
Operating revenues:		
Water	\$ 755,937	\$ 504,676
Sewer	406,135	266,422
Bad debt expense	(34,650)	(35,405)
Total net operating revenues	<u>1,127,422</u>	<u>735,693</u>
Operating expenses:		
Payroll and payroll related	291,639	272,092
Service contract – Superaqueduct	3,908	5,679
Professional and consulting services	32,371	31,575
Chemicals	28,659	28,872
Materials and replacements	18,085	12,731
Repairs and maintenance of capital assets	45,134	45,214
Electricity	166,720	209,168
Insurance	9,492	9,493
Other operating expenses	118,614	84,046
Operating expenses (excluding depreciation and amortization and cost of assets disposed of)	<u>714,622</u>	<u>698,870</u>
Depreciation and amortization	258,850	244,734
Cost of assets disposed of	11,143	96,508
Total operating expenses	<u>984,615</u>	<u>1,040,112</u>
Operating income (loss)	<u>142,807</u>	<u>(304,419)</u>
Nonoperating revenues (expenses):		
Interest expense, net of amortization of bond premium and discount, and deferred refunding loss	(224,162)	(205,443)
Commonwealth contributions for interest payments on bonds and notes	5,856	5,856
Interest income	4,467	7,478
Other income	4,080	5,202
Total nonoperating revenues (expenses), net	<u>(209,759)</u>	<u>(186,907)</u>
Loss before capital contributions	<u>(66,952)</u>	<u>(491,326)</u>
Capital contributions:		
Federal grants and other contributions	25,906	19,859
Other Commonwealth contributions	–	276
Total capital contributions	<u>25,906</u>	<u>20,135</u>
Change in net position	<u>(41,046)</u>	<u>(471,191)</u>
Net position at beginning of year, <i>as restated</i>	2,420,025	2,891,216
Net position at end of year	<u>\$ 2,378,979</u>	<u>\$ 2,420,025</u>

See accompanying notes.

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

Statements of Cash Flows
(In thousands)

	Year Ended June 30	
	2014	2013
	<i>(as restated)</i>	
Cash flows from operating activities		
Cash received from customers	\$ 1,042,411	\$ 750,007
Cash paid to suppliers	(443,552)	(392,936)
Cash paid to employees	(291,791)	(284,289)
Net cash provided by operating activities	<u>307,068</u>	<u>72,782</u>
Cash flows from noncapital financing activities		
Net cash from other income	4,080	5,202
Interest paid on notes and lines of credit	(4,342)	(4,342)
Net cash (used in) provided by noncapital financing activities	<u>(262)</u>	<u>860</u>
Cash flows from capital and related financing activities		
Additions to utility plant and other capital assets	(394,587)	(364,417)
Proceeds from capital contributions	26,265	20,705
Proceeds from issuance of bonds	-	45,562
Proceeds from issuance of notes payable	241,530	39,357
Proceeds from borrowings from lines of credit	56,601	35,367
Payments of bonds and notes	(41,329)	(40,957)
Payment of lines of credit	(65,824)	(55,320)
Interest paid on bonds, notes and lines of credit	(190,478)	(159,685)
Net cash used in capital and related financing activities	<u>(367,822)</u>	<u>(479,388)</u>
Cash flows from investing activities		
Interest received on investments	4,467	7,478
Net cash provided by investing activities	<u>4,467</u>	<u>7,478</u>
Net change in cash and cash equivalents	<u>(56,549)</u>	<u>(398,268)</u>
Cash and cash equivalents at beginning of year	519,494	917,762
Cash and cash equivalents at end of year	<u>\$ 462,945</u>	<u>\$ 519,494</u>
For purposes of the statement of cash flows, cash and cash equivalents include:		
Unrestricted	\$ 67,982	\$ 101,680
Restricted	394,963	417,814
	<u>\$ 462,945</u>	<u>\$ 519,494</u>

(Continued)

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

Statements of Cash Flows (continued)
(In thousands)

	Year Ended June 30	
	2014	2013
	<i>(as restated)</i>	
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income (loss)	\$ 142,807	\$ (304,419)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation and amortization	258,850	244,734
Cost of assets disposed of	11,143	96,508
Provision for uncollectible accounts	34,650	35,405
Change in assets and liabilities:		
Accounts receivable	(120,973)	(20,610)
Accounts receivable from federal agencies	(624)	181
Materials and supplies inventory	(4,931)	(3,927)
Prepayments and other current assets	894	912
Accounts payable	(54,484)	45,549
Unearned revenue	405	(1,752)
Accrued compensated absences and early retirement obligation	2,648	2,562
Accrued liabilities	35,776	(23,632)
Customers' deposits	907	1,271
Total adjustments	164,261	377,201
Net cash provided by operating activities	\$ 307,068	\$ 72,782
Noncash capital and related financing activities		
Net additions to utility plant and other capital assets	\$ 19,188	\$ 25,948
Write-off of capital contributions	359	570
Amortization of:		
Bond premiums and discounts	316	299
Deferred refunding loss	3,746	3,564
Interest paid by the Commonwealth	22,887	23,835

See accompanying notes.

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

Notes to Financial Statements

June 30, 2014

1. Reporting Entity and Summary of Significant Accounting Policies

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

Summary of Significant Accounting Policies

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

Measurement Focus and Basis of Accounting

The Authority's operations are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the balance 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.

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

Notes to Financial Statements (continued)

June 30, 2014

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

Measurement Focus and Basis of Accounting (continued)

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

Cash and Cash Equivalents

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

The Authority maintains some construction fund accounts related to past bond issuances invested in mutual funds. As of June 30, 2014 and 2013, the account balances amounted to approximately \$7.8 million and \$35 million, respectively. The accounts are held under the Puerto Rico Government Investment Trust Fund (the Trust Fund), a collective investment trust created by the Secretary of the Treasury of Puerto Rico as settler and the Government Development Bank of Puerto Rico as trustee. The Trust Fund seeks to maintain a constant net asset value per unit of \$1 through investment in high-grade short term money market instruments with a dollar-weighted average portfolio maturity of less than 60 days, including, but not limited to, obligations of the U.S. Government, the Puerto Rico Government, their respective agencies and instrumentalities, repurchase agreements with respect to obligations of the U.S. Government, certificates of deposit, time deposits, bank notes and banker's acceptances issued by the U.S. or Puerto Rico regulated banks, commercial paper and corporate obligations. The Authority can invest, reinvest or redeem units acquired at any time without charge or penalty.

The Trust Fund values its investments on the basis of amortized cost. Although the Trust Fund's policies are designed to help maintain a stable net asset value per unit of \$1.0, all money market instruments can change in value when interest rates or issuers' creditworthiness change, or if an issuer or guarantor of a security fails to pay interest or principal when due. As of June 30, 2014 and 2013, the net asset value per unit of the Trust Fund was \$1.0.

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

Notes to Financial Statements (continued)

June 30, 2014

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

Restricted Assets

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

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

Receivables

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

Materials and Supplies Inventory

Materials and supplies inventory is stated at average cost, not to exceed market. Inventory is presented net of a reserve for obsolescence totaling approximately \$1.4 million and \$1.0 million as of June 30, 2014 and 2013, respectively.

Unamortized Premiums, Discounts and Deferred Refunding Losses

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

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

Bonds payable are reported net of applicable bond premium or discount. For fiscal year 2013 and 2014, as a result of the adoption of GASB Statement No.65, the unamortized debt issuance costs are classified as nonoperating expenses and the deferred loss from debt refunding as deferred outflows of resources on the accompanying balance sheets.

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

Notes to Financial Statements (continued)

June 30, 2014

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

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. Interest capitalized by the Authority for the years ended June 30, 2014 and 2013 amounted to approximately \$44.0 million and \$56.9 million, respectively.

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

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

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

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

Unearned Revenue

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

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

Notes to Financial Statements (continued)

June 30, 2014

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

Accounting for Compensated Absences

Employees earn vacation and sick leave based on a prescribed formula. The amount of vacation and sick leave earned and not used by the Authority's employees is accrued as a liability as the benefits are earned by the employees and if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the Authority will compensate the employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement. Accrued compensated absences include payroll related expenses.

The cost of compensated absences expected to be paid in the next twelve months is classified as a current liability while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

Postemployment Health Benefits

The Authority provides certain healthcare benefits for retired employees. Substantially all of the Authority's employees may become eligible for these benefits if they meet the required years of service working for the Authority.

The Authority has the obligation to contribute a maximum of \$125 monthly per retired employee for coverage under the medical plan. The Authority accounts for its postretirement healthcare benefits in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, as detailed in Note 17.

The Authority maintains an Early Retirement Program established during fiscal year 2002, which provides for a monthly payment to certain retired employees to cover healthcare premiums for a maximum of \$280 per month, up to the age of seventy (70) years or for a maximum of ten (10) years, whichever occurs first. The present value of future healthcare benefit contributions for these early retired employees is accrued and reported as a liability in the accompanying balance sheets. As of June 30, 2013, the accrued liability for early retirement amounted to approximately \$0.1 million and as of June 30, 2014 there was no outstanding balance.

The total cost of healthcare benefits paid to retired employees amounted to approximately \$3 million and \$3.2 million for fiscal years 2014 and 2013, respectively.

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

Notes to Financial Statements (continued)

June 30, 2014

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

Pension Benefits

As detailed in note 16, the Authority's employees participate in the Government of Puerto Rico Employees Retirement System (the Plan), a cost-sharing, multiple-employers defined benefit pension plan. The Authority recognizes annual pension expense equal to its required contribution to the Plan. The Commonwealth funds any past or future unfunded liability related to the Authority's employees.

Net Position

Net position is reported in three categories:

- ▶ ***Net Investment in Capital Assets*** – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Debt pertaining to significant unspent debt proceeds is not included in the calculation of net investment in capital assets.
- ▶ ***Restricted Net Position*** – These result when constraints on the use of net assets are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. At June 30, 2014 and 2013, the Authority had no assets restricted by enabling legislation.
- ▶ ***Unrestricted Net Position*** – These 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 does not consider certain amounts to be available for general operations. Unrestricted net position often has constraints on resources that are imposed by management that can be removed or modified.

Use of Estimates

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

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

Notes to Financial Statements (continued)

June 30, 2014

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

Future Adoption of Accounting Standards

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

GASB Statement No.		Adoption required in fiscal year
68	Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27	2015
69	Government Combinations and Disposals of Government Operations	2015
71	Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No. 68	2015

Effects of New Pronouncements

The following GASB statements were effective for fiscal year 2014: Statement No. 66, Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62; Statement No.67, Financial Reporting for Pension Plans – an amendment of GASB Statement No.25; Statement *No.70 Accounting and Financial Reporting for Nonexchange Financial Guarantees*. These statements had no impact on the Authority.

GASB No. 65, *Items Previously Reported as Assets and Liabilities*, was issued on March 2012. The objective of this statement is to either (a) properly classify certain items previously reported as assets or liabilities as deferred outflows of resources and deferred inflows of resources, (b) recognize certain items that were previously reported as assets and liabilities as outflows of resources (expense) or inflows of resources (revenue). These determinations are based on the definitions of those elements in Concepts Statements No.4 – Elements of Financial Statements. A deferred outflow of resources is a consumption of net assets by government applicable to future periods and deferred inflows of resources is an acquisition of net assets by government applicable to future periods. GASB No. 65 is effective for financial statements periods beginning after December 15, 2012. The Authority has adopted the provisions of the GASB Statement No. 65 for the year ended on June 30, 2014. The adoption of this Statement required a restatement of the beginning net position balance of the earliest comparative period presented of the Authority's financial statements. See Note 21 for further discussion.

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

Notes to Financial Statements (continued)

June 30, 2014

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

Commonwealth Appropriations

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

2. Deposits

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

	June 30			
	2014		2013	
	Carrying amount	Bank balance	Carrying amount	Bank balance
Unrestricted deposits in commercial banks in Puerto Rico	\$ 67,982	\$ 75,872	\$ 101,680	\$ 105,860
Restricted deposits in commercial banks in Puerto Rico	359,809	359,809	273,358	273,358
Restricted deposits in governmental banks:				
GDB	31,524	31,524	116,382	116,382
EDB	3,630	3,630	28,074	28,074
Total	\$ 462,945	\$ 470,835	\$ 519,494	\$ 523,674

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

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

Notes to Financial Statements (continued)

June 30, 2014

2. Deposits (continued)

Custodial Credit Risks Related to Deposits

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

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

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

	June 30	
	2014	2013
Uninsured and uncollateralized:		
GDB	\$ 31,524	\$ 116,382
EDB	3,630	28,074
	\$ 35,154	\$ 144,456

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

Notes to Financial Statements (continued)

June 30, 2014

3. Accounts Receivable

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

	June 30	
	2014	2013
Water and sewer services:		
Residential, industrial, and commercial	\$ 594,327	\$ 514,375
Government agencies and municipalities	124,137	82,997
	718,464	597,372
Other receivables:		
Government agencies and municipalities	3,410	3,374
Private entities	29,192	29,347
	32,602	32,721
	751,066	630,093
Less allowance for uncollectible accounts	(506,884)	(471,875)
Total	\$ 244,182	\$ 158,218

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

Notes to Financial Statements (continued)

June 30, 2014

4. Other Receivables

Receivables from Federal Agencies

Receivables from federal agencies of approximately \$3.3 million and \$2.7 million as of June 30, 2014 and 2013, respectively, consisted primarily of amounts to be received from the U.S. Department of Homeland Security (USDHS) as reimbursement for expenses incurred by the Authority's disaster recovery activities.

Receivables from Commonwealth

Receivables from Commonwealth of approximately \$16.8 million and \$33.8 million as of June 30, 2014 and 2013, respectively, consisted of proceeds from PFC 2011 Series A and B, and 2012 Series A Refunding Bonds that will be used by the Commonwealth to pay interest on bonds.

5. Materials and Supplies Inventory

As of June 30, 2014 and 2013, material and supplies inventory consisted of the basic materials needed for the operation and maintenance of the water and sewer system and for the replacement of water meters.

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

Notes to Financial Statements (continued)

June 30, 2014

6. Capital Assets

Utility plant and other capital assets as of June 30, 2014 and 2013 and the changes therein for the years then ended are as follows (in thousands):

	June 30, 2014			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 61,983	\$ 1,310	\$ -	\$ 63,293
Easement	9,205	498	-	9,703
Construction in progress	822,171	373,176	(546,336)	649,011
Total capital assets not being depreciated	<u>893,359</u>	<u>374,984</u>	<u>(546,336)</u>	<u>722,007</u>
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	8,723,157	502,119	(77,888)	9,147,388
Wells, tanks and meters	683,598	34,431	(3,349)	714,680
Buildings and improvements	82,989	14,779	-	97,768
Equipment, furniture, fixtures and vehicles	283,661	59,296	-	342,957
Total capital assets being depreciated	<u>9,773,405</u>	<u>610,625</u>	<u>(81,237)</u>	<u>10,302,793</u>
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,866,449)	(212,759)	3,869	(3,075,339)
Wells, tanks and meters	(179,352)	(26,650)	2,350	(203,652)
Buildings and improvements	(33,563)	(2,277)	-	(35,840)
Equipment, furniture, fixtures and vehicles	(223,047)	(17,164)	-	(240,211)
Total accumulated depreciation and amortization	<u>(3,302,411)</u>	<u>(258,850)</u>	<u>6,219</u>	<u>(3,555,042)</u>
Total capital assets being depreciated, net	<u>6,470,994</u>	<u>351,775</u>	<u>(75,018)</u>	<u>6,747,751</u>
Total capital assets, net	<u>\$ 7,364,353</u>	<u>\$ 726,759</u>	<u>\$ (621,354)</u>	<u>\$ 7,469,758</u>

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

Notes to Financial Statements (continued)

June 30, 2014

6. Capital Assets (continued)

	June 30, 2013 (As restated)			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 61,004	\$ 981	\$ (2)	\$ 61,983
Easement	8,927	285	(7)	9,205
Construction in progress	1,482,269	371,323	(1,031,421)	822,171
Total capital assets not being depreciated	<u>1,552,200</u>	<u>372,589</u>	<u>(1,031,430)</u>	<u>893,359</u>
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	7,901,488	844,517	(22,848)	8,723,157
Wells, tanks and meters	584,463	106,053	(6,918)	683,598
Buildings and improvements	78,572	4,419	(2)	82,989
Equipment, furniture, fixtures and vehicles	278,730	19,590	(14,659)	283,661
Total capital assets being depreciated	<u>8,843,253</u>	<u>974,579</u>	<u>(44,427)</u>	<u>9,773,405</u>
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,672,007)	(207,075)	12,633	(2,866,449)
Wells, tanks and meters	(159,635)	(23,550)	3,833	(179,352)
Buildings and improvements	(31,605)	(1,958)	-	(33,563)
Equipment, furniture, fixtures and vehicles	(216,976)	(12,151)	6,080	(223,047)
Total accumulated depreciation and amortization	<u>(3,080,223)</u>	<u>(244,734)</u>	<u>22,546</u>	<u>(3,302,411)</u>
Total capital assets being depreciated, net	<u>5,763,030</u>	<u>729,845</u>	<u>(21,881)</u>	<u>6,470,994</u>
Total capital assets, net	<u>\$ 7,315,230</u>	<u>\$ 1,102,434</u>	<u>\$ (1,053,311)</u>	<u>\$ 7,364,353</u>

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

Notes to Financial Statements (continued)

June 30, 2014

7. Restricted Assets

Restricted assets at June 30, 2014 and 2013 consisted of the following:

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

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

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

Restricted assets by category consist of:

	June 30	
	2014	2013
Construction funds	\$ 65,776	\$ 91,018
Capital activity funds	20,991	104,997
Debt service funds	308,196	221,799
	\$ 394,963	\$ 417,814

8. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	June 30	
	2014	2013
Payroll and related accruals	\$ 39,382	\$ 33,655
Legal, labor related and environmental contingencies	81,158	52,624
Contract retentions	31,935	30,423
	\$ 152,475	\$ 116,702

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

Notes to Financial Statements (continued)

June 30, 2014

9. Long-Term Liabilities

Long-term debt activity for the years ended June 30, 2014 and 2013 was as follows (in thousands):

	June 30, 2014					
	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	1,331,965	-	(12,905)	1,319,060	13,550	1,305,510
2008 Series B Revenue Bonds	22,445	-	-	22,445	-	22,445
2008 Series A Revenue Refunding Bonds	159,055	-	-	159,055	-	159,055
2008 Series B Revenue Refunding Bonds	125,700	-	-	125,700	-	125,700
2012 Series A Revenue Bonds	1,800,450	-	-	1,800,450	-	1,800,450
2012 Series B Revenue Bonds	295,245	-	-	295,245	31,035	264,210
Rural Development Serial Bonds	405,064	-	(8,064)	397,000	4,159	392,841
Sub total bonds	<u>4,551,153</u>	<u>-</u>	<u>(20,969)</u>	<u>4,530,184</u>	<u>48,744</u>	<u>4,481,440</u>
Add bond premium	27,302	-	(485)	26,817	512	26,305
Less bond discount	<u>(16,386)</u>	<u>-</u>	<u>169</u>	<u>(16,217)</u>	<u>(179)</u>	<u>(16,038)</u>
Total bonds	<u>4,562,069</u>	<u>-</u>	<u>(21,285)</u>	<u>4,540,784</u>	<u>49,077</u>	<u>4,491,707</u>
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	469,743	41,530	(20,358)	490,915	35,501	455,414
Notes with GDB	-	72,363	-	72,363	6,069	66,294
Notes with commercial banks	-	200,000	-	200,000	200,000	-
Total notes	<u>469,743</u>	<u>313,893</u>	<u>(20,358)</u>	<u>763,278</u>	<u>241,570</u>	<u>521,708</u>
Lines of credit	<u>89,835</u>	<u>56,601</u>	<u>(138,187)</u>	<u>8,249</u>	<u>-</u>	<u>8,249</u>
Other long-term liabilities:						
Accrued compensated absences	43,136	15,436	(16,883)	41,689	12,918	28,771
Net OPEB obligation	28,141	7,091	(2,902)	32,330	7,092	25,238
Early retirement obligation	93	-	(93)	-	-	-
Customers' deposits	<u>82,247</u>	<u>10,110</u>	<u>(9,203)</u>	<u>83,154</u>	<u>6,846</u>	<u>76,308</u>
Total other liabilities	<u>153,617</u>	<u>32,637</u>	<u>(29,081)</u>	<u>157,173</u>	<u>26,856</u>	<u>130,317</u>
Total - long-term obligations	<u>\$ 5,275,264</u>	<u>\$ 403,131</u>	<u>\$ (208,911)</u>	<u>\$ 5,469,484</u>	<u>\$ 317,503</u>	<u>\$ 5,151,981</u>

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

Notes to Financial Statements (continued)

June 30, 2014

9. Long-Term Liabilities (continued)

	June 30, 2013 <i>(As restated)</i>					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
	<i>(As restated)</i>					
Bonds payable:						
2011 Series A PFC Commonwealth Appropriation Bonds	\$ 90,099	\$ -	\$ -	\$ 90,099	\$ -	\$ 90,099
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	-	-	102,183	-	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduct)	162,700	-	-	162,700	-	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	-	-	56,247	-	56,247
2008 Series A Revenue Bonds	1,344,255	-	(12,290)	1,331,965	12,905	1,319,060
2008 Series B Revenue Bonds	22,445	-	-	22,445	-	22,445
2008 Series A Revenue Refunding Bonds	159,055	-	-	159,055	-	159,055
2008 Series B Revenue Refunding Bonds	125,700	-	-	125,700	-	125,700
2012 Series A Revenue Bonds	1,800,450	-	-	1,800,450	-	1,800,450
2012 Series B Revenue Bonds	295,245	-	-	295,245	-	295,245
Rural Development Serial Bonds	368,511	45,561	(9,008)	405,064	3,995	401,069
Sub total bonds	<u>4,526,890</u>	<u>45,561</u>	<u>(21,298)</u>	<u>4,551,153</u>	<u>16,900</u>	<u>4,534,253</u>
Add bond premium	27,762	-	(460)	27,302	486	26,816
Less bond discount	(16,547)	-	161	(16,386)	(170)	(16,216)
Total bonds	<u>4,538,105</u>	<u>45,561</u>	<u>(21,597)</u>	<u>4,562,069</u>	<u>17,216</u>	<u>4,544,853</u>
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	450,044	39,357	(19,658)	469,743	19,605	450,138
Total notes	<u>450,044</u>	<u>39,357</u>	<u>(19,658)</u>	<u>469,743</u>	<u>19,605</u>	<u>450,138</u>
Lines of credit	<u>109,788</u>	<u>35,367</u>	<u>(55,320)</u>	<u>89,835</u>	<u>89,835</u>	<u>-</u>
Other long-term liabilities:						
Accrued compensated absences	45,271	10,753	(12,888)	43,136	12,725	30,411
Net OPEB obligation	22,652	7,881	(2,392)	28,141	7,881	20,260
Early retirement obligation	886	-	(793)	93	93	-
Customers' deposits	80,976	9,266	(7,995)	82,247	6,584	75,663
Total other liabilities	<u>149,785</u>	<u>27,900</u>	<u>(24,068)</u>	<u>153,617</u>	<u>27,283</u>	<u>126,334</u>
Total - long-term obligations	<u>\$ 5,247,722</u>	<u>\$ 148,185</u>	<u>\$ (120,643)</u>	<u>\$ 5,275,264</u>	<u>\$ 153,939</u>	<u>\$ 5,121,325</u>

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable

Bonds payable consisted of the following (in thousands):

	June 30	
	2014	2013
		<i>(Restated)</i>
PFC Commonwealth Appropriation Bonds:		
Series 2011:		
Series A, 6.50%, due in semiannual interest payments through August 1, 2028 and annual principal installments from August 1, 2027 to 2028	\$ 90,099	\$ 90,099
Series B, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	102,183	102,183
Series B - Superaqueduct, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	162,700	162,700
Series 2012:		
Series A, 3.10% - 5.35%, due in monthly interest payments through August 1, 2031 and annual principal installments from August 1, 2015 to 2031	56,247	56,247
Revenue Refunding Bonds:		
Series 2008:		
Series A and B, Term Bonds, 5.80% – 6.10%, due in monthly interest payments through July 1, 2034 and annual principal payments from July 1, 2021 to 2034	284,755	284,755
Revenue bonds:		
Series 2008:		
Series A, Serial Bonds, 5.00%, due in semiannual interest payments through July 1, 2025 and annual principal payments from July 1, 2012 to July 1, 2025	67,960	80,865
Series A, Convertible Capital Appreciation Bonds, 6.125%, due in semiannual interest payments from January 1, 2012 through July 1, 2024 and annual principal payments from July 1, 2017 to 2024	155,975	155,975

(Continued)

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

	June 30	
	2014	2013 <i>(Restated)</i>
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 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	418,455	418,455
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2033 to July 1, 2047	1,381,995	1,381,995
Series B, Serial Bonds, 3.35% - 5.00%, due in semiannual interest payments through July 1, 2023 and annual principal payments from July 1, 2014 to July 1, 2023	188,130	188,130
Series B, Term Bonds, 5.35%, due in semiannual interest payments through July 1, 2027 and one principal payment on July 1, 2027	107,115	107,115
Rural development serial bonds:		
Serial Bonds, 2.00% - 5.00%, due semiannually through July 1, 2050	397,000	405,064
Subtotal	4,530,184	4,551,153
Bond premium	26,816	27,302
Bond discount	(16,216)	(16,386)
Total	<u>\$ 4,540,784</u>	<u>\$ 4,562,069</u>

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

Act 164 PFC Bonds

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

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

The 2001 Series C and E Bonds are secured by promissory note payments made by the Commonwealth to PFC pursuant to a Debt Restructuring and Assignment Agreement dated July 1, 2001, between the debtors, including the Authority, and PFC. In accordance with Act 164, such payments shall be funded by Commonwealth appropriations approved annually up to a maximum of approximately \$225.0 million per fiscal year for a term of 30 years. The Commonwealth is not legally bound to appropriate funds for such promissory notes payments. On June 28, 2004, PFC issued approximately \$1,206.1 million of 2004 Series A Refunding Bonds at a premium of approximately \$89.4 million, and approximately \$146.9 million of 2004 Series B Refunding Bonds, for the purpose of refunding a portion of certain of its outstanding bonds.

The net proceeds from the 2004 Series A and B Refunding Bonds amounting to approximately \$1,395 million, after payment of the cost of issuance and bond premium of approximately \$47.4 million, were used to advance refund a portion of PFC's previously issued bonds in order to obtain lower interest rates. The Authority's allocable share of the total refunded debt was approximately \$734.0 million at the issuance date including the unrefunded original PFC debt and the refunded debt through 2004 Series A and B.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

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

On July 31, 2007, December 20, 2007 and June 26, 2008, the Puerto Rico Sales Tax Financing Corporation (known as COFINA), issued its Sales Tax Revenue Bonds Series 2007A and 2007B, Series 2007C and Series 2009A, respectively, to refinance certain of the Act 164 PFC Bonds outstanding and the corresponding notes issued by PFC by certain of the Commonwealth's agencies and component units, (including the Authority). The Series 2009A and B proceeds were deposited in escrow with The Bank of New York/Mellon as master escrow agent. As a result, approximately \$180.2 million of the Authority's share of the Act 164 PFC Bonds were considered legally defeased. The proceeds of the Series 2007C Bonds were used, in part, to purchase and cancel approximately \$61.4 million of the Authority's share of the Act 164 PFC Bonds. The proceeds of the Series 2009A Bonds were used to purchase and cancel approximately \$127.4 million of the Authority's share of the Act 164 PFC Bonds.

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

On August 18, 2011, December 8, 2011 and June 28, 2012, PFC issued 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 of PFC's previously issued bonds in order to obtain lower interest rates.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

The Authority's share of 2011 Series A, 2011 Series B and 2012 Series A PFC Refunding Bonds of approximately \$90.1 million, \$264.9 million and \$56.2 million, respectively was recorded in Authority's balance sheets at June 30, 2014 and 2013.

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

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

2004 Series A PFC Refunding Bonds

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

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

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

2004 Series A PFC Refunding Bonds (continued)

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

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

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 the refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund a portion of PFC's previously issued bonds. The Authority's share on these previous bond issuances was removed from balance sheets.

As of June 30, 2014, 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.

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.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

2008 Series A and B Revenue Bonds (continued)

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, 2014 and 2013, the outstanding balance for the 2008 Revenue Bonds Series A was approximately \$1,319.1 million and \$1,332 million, respectively, which included approximately \$28.0 million of accreted value.

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

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

2008 Series A and B Revenue Refunding Bonds

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

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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

2008 Series A and B Revenue Refunding Bonds (continued)

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 inflow 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, 2014 and 2013 the outstanding balance for the 2008 Series A and B refunding Bonds was \$284.8 million.

2012 Series A and B Revenue Bonds

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

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

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

2012 Series A and B Revenue Bonds (continued)

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

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

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

The 2012 Revenue Bonds are considered senior debt. As of June 30 2014 and 2013, the outstanding balance for 2012 Series A and B was \$2,095.7 million.

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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

Rural Development Serial Bonds

United States Department of Agriculture (USDA) Rural Development Program assists the Authority in the financing and construction of aqueduct and sewer facilities in rural areas by purchasing revenue bonds from the Authority, the proceeds of which are used by the Authority to finance such projects. GDB provides interim financing for these projects through short-term lines of credit.

On June 12, 2013, the Authority issued approximately \$45.5 million of Series II of USDA Rural Development Program Bonds, at a maximum interest of 2.0% - 5.00%, payable semiannually and maturing in semiannually installments through July 1, 2050. The funds raised by this issuance were used to partially repay the outstanding balance of USDA Rural Development Program lines of credit for construction projects from GDB.

As of June 30, 2014, the USDA Rural Development Program Bonds consisted of twenty-six (26) separate series, issued from 1983 through 2013, bearing interest from 2.0% vs. 5.00% due in semiannual installments through 2050. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2014 and 2013 was approximately \$397.0 million and \$405.0 million, respectively.

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

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

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Notes to Financial Statements (continued)

June 30, 2014

10. Bonds Payable (continued)

Debt Service Payments

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

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year:			
2015	\$ 48,744	\$ 233,543	\$ 282,287
2016	62,607	239,134	301,741
2017	63,852	236,360	300,212
2018	66,487	233,331	299,818
2019	69,763	229,990	299,753
2020 – 2024	419,976	1,090,511	1,510,487
2025 – 2029	759,274	948,964	1,708,238
2030 – 2034	851,916	708,849	1,560,765
2035 – 2039	778,328	489,182	1,267,510
2040 – 2044	866,753	259,911	1,126,664
2045 – 2049	527,299	60,278	587,577
2050 – 2054	15,185	940	16,125
	<u>4,530,184</u>	<u>\$ 4,730,993</u>	<u>\$ 9,261,177</u>
Total	4,530,184	\$ 4,730,993	\$ 9,261,177
Plus unamortized premium	26,816		
Less:			
Unamortized discount	<u>(16,216)</u>		
Bonds payable, net	<u>\$ 4,540,784</u>		

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

11. Notes Payable

Notes payable consisted of the following (in thousands):

	June 30	
	2014	2013
Puerto Rico Water Pollution Control Revolving Fund	\$ 331,931	\$ 315,334
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	158,984	154,409
Note with GDB	72,363	—
Notes with commercial banks	200,000	—
	\$ 763,278	\$ 469,743

The Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the Revolving Funds) were created by Act No. 44 of June 21, 1988 and Act No. 32 of July 7, 1997, respectively, of the Commonwealth. The Puerto Rico Water Pollution Control Revolving Fund is administered, pursuant to Act No. 44 and Act No. 9 of June 21, 1988 and June 18, 1970, respectively, as amended, by the Puerto Rico Environmental Quality Board (EQB). The Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund is administered, pursuant to Act No. 5 of July 21, 1977, as amended, by the Puerto Rico Department of Health (DOH).

Pursuant to these laws, EQB and DOH, on behalf of the Commonwealth, are authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA). Puerto Rico Infrastructure Financing Authority (PRIFA), a component unit of the Commonwealth, the Authority, and GDB entered into a memorandum of understanding under which each party has agreed to assume specific responsibilities in connection with the operations of the Revolving Funds.

The Authority has entered into revolving loan agreements with PRIFA to finance certain capital improvements to the system. As of June 30, 2014 and 2013, the Authority had outstanding approximately \$490.9 million and \$469.7 million, respectively, under these loan agreements.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

11. Notes Payable (continued)

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

As authorized by the Authority's Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the Credit Agreement), as amended on February 26, 2014, with the Lenders party thereto and Oriental Bank, a financial institution organized under the laws of the Commonwealth as Administrative Agent for the Lenders, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to \$350 million to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust. This note had an outstanding balance of \$200 million as of June 30, 2014, and was designated by the Authority as Senior Indebtedness pursuant to the terms of the Master Agreement of Trust. On March 4, 2015, the Authority executed an amendment to the Credit Agreement originally executed on October 24, 2013, by and among PRASA, Oriental Bank as Administrative Agent and Banco Popular de Puerto Rico (BPPR) as a Lender. With the execution of this amendment, the local commercial bank syndicate agreed to extend the maturity date on the credit facility granted under the Credit Agreement through May 29, 2015. As a condition to such extension, PRASA agreed to make a principal payment in an aggregate amount of \$50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders \$40 million, reducing the outstanding principal amount of the indebtedness to \$160 million, and agreed to make two additional \$5 million principal payments on April 1, 2015 and May 1, 2015. The Authority does not currently have sufficient funds available to fully repay on May 29, 2015, the amount that will be outstanding on that date of \$150 million and is working on a bond issuance scheduled, to be closed prior to the note payable extended due date, to provide funds to cancel the outstanding balance at the date of the transaction, and to finance capital improvement projects. Management has alternative plans to repay the outstanding note payable balance by its due date if the bond issuance is not closed. However, there can be no assurance the projected bond issuance will be closed by the planned date and/or amount, or that management's alternative ways to repay the note or extend its due date will be achieved, such that a default on the note or other obligations that have cross default provisions will be avoided.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

11. Notes Payable (continued)

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

The combined future aggregate amount of debt service for these loans as of June 30, 2014 was as follows (in thousands):

	Principal	Interest	Total
2015	\$ 241,570	\$ 24,732	\$ 266,302
2016	27,997	9,910	37,907
2017	28,353	9,153	37,506
2018	26,573	8,401	34,974
2019	72,524	7,422	79,946
2020 – 2024	103,914	17,016	120,930
2025 – 2029	89,319	6,884	96,203
2030 – 2034	24,013	885	24,898
	614,263	\$ 84,403	\$ 698,666

Interim construction loans:

Puerto Rico Water Pollution Control			
Revolving Fund	120,702		
Puerto Rico Safe Drinking Water			
Treatment Revolving Loan Fund	28,313		
Total	\$ 763,278		

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

12. Lines of Credit

On March 18, 2008, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of \$150.0 million to be used to satisfy the Operating Reserve Requirement pursuant to the Master Agreement of Trust dated as of March 1, 2008 between the Authority and the bond trustee related to the 2008 Revenue Bonds. On February 29, 2012, the maximum amount was increased to \$180.0 million. This line of credit is due on June 30, 2016. There was no outstanding balance as of June 30, 2014 and 2013.

On March 10, 2010, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of \$70.0 million to be used to provide funding for the capital improvement program of the Authority. The proceeds will be applied only to projects approved and to be funded by the State Revolving Funds pursuant to federal regulations under the Clean Water Act, the Safe Drinking Water Act, and the American Recovery Act (“ARRA”). The Authority will pay this interim financing with moneys received from State Revolving Funds, as reimbursements on payments done by the Authority for the projects. As of June 30, 2014 and 2013, the Authority had an outstanding balance of approximately \$8.2 million and \$17.5 million on this line of credit, respectively. The line of credit is due on January 31, 2016.

Future amounts required to pay principal balances at June 30, 2014 are as follows (in thousands):

Fiscal year:	
2015	\$ -
2016	8,249
	<u>8,249</u>
	<u><u>\$ 8,249</u></u>

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

13. Financial Covenants

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

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

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

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

As of June 30, 2014 and 2013, the Authority was in compliance with the senior annual debt service coverage requirements.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

14. Capital Contributions

Capital contributions for the fiscal years ended June 30, 2014 and 2013 were as follows (in thousands):

	June 30	
	2014	2013
Other contributions from Commonwealth	\$ —	\$ 276
Contributions from governmental agencies and municipalities	432	44
Federal grants:		
USDA Rural Development Program	12,751	10,975
Federal Emergency Management Agency	879	11
American Recovery and Reinvestment Act Funds	3,871	2,058
Developer contributions	6,524	5,545
Other contributions	1,449	1,226
	\$ 25,906	\$ 20,135

15. Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately \$75.3 million and \$83.6 million during the years ended June 30, 2014 and 2013, respectively. Further, operating, administrative, and general expenses during the fiscal years ended June 30, 2014 and 2013 included approximately \$166.7 million and \$209.2 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2014 and 2013, the Authority had approximately \$16.8 million and \$33.8 million, respectively, of receivables from the Commonwealth and its component units, which are reported as receivables from the Commonwealth in the accompanying balance sheets.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

15. Related Party Transactions (continued)

The Authority had approximately \$1.1 million and \$1.3 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the accompanying balance sheets as of June 30, 2014 and 2013, respectively.

Over the years, GDB, as fiscal agent and bank of the Commonwealth, had extended lines of credit to the Authority in order to finance capital improvement projects and operational needs. As of June 30, 2014 and 2013, the Authority had an outstanding balance of approximately \$8.2 million and \$89.8 million, respectively, under these lines of credit.

16. Pension Plan

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

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

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

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

16. Pension Plan (continued)

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

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

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

System 2000 reduced the retirement age from sixty-five (65) years to sixty (60) for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000. The employers' contributions of 12.275% of the employee's gross salary during fiscal year 2014 were used to fund the defined benefit plan.

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

16. Pension Plan (continued)

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

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

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

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

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

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

Under Act 447 the Authority’s contributions during fiscal year 2014 were 12.275% of the gross monthly salary. Total employer contributions during years ended June 30, 2014, 2013 and 2012 amounted to approximately \$8.5 million, \$9.3 million and \$9.2 million, respectively, which represented 100% of required contributions.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

16. Pension Plan (continued)

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

The Authority contributions under System 2000 plan during the fiscal years ended June 30, 2014, 2013 and 2012, amounted to approximately \$8.2 million, \$7.1 million and \$5.4 million, respectively, which represented 100% of required contributions.

Under Act 3, the Authority contributions for the hybrid program during fiscal year ended on June 30, 2014, amounted to approximately \$ 0.7 million.

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

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

<u>Age at June 30, 2014</u>	<u>Age under new program</u>
57 years or more	59 years
56 years	60 years
55 years or less	61 years

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

<u>Age at June 30, 2014</u>	<u>Age under new program</u>
65 years or less	65 years

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

16. Pension Plan (continued)

For participants who entered the program after January 1, 2000 through June 30, 2014 (System 2000):

<u>Age at June 30, 2014</u>	<u>Age under new program</u>
59 years	61 years
58 years	62 years
57 years	63 years
56 years	64 years
55 years or less	65 years

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

By means of Act 3, an amendment to Act No. 447 of May 15, 1951, which create section 5-117, was enacted for the purpose of reduced the cash flow deficit in the ERS, for each fiscal year and beginning on fiscal year 2013-2014 and throughout fiscal year 2032-2033 the ERS will receive a contribution equal to the additional uniform benefits. For each fiscal year the ERS will determine the portion amount based on the Authority on the total employer contributions percentage for the current fiscal year. For the fiscal year ended June 30, 2014, the Authority contribution for additional benefits uniform was \$4.4 million.

Additional information on the ERS is provided in its financial statements for the years ended June 30, 2014 and 2013, a copy of which can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

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Notes to Financial Statements (continued)

June 30, 2014

17. Other Postemployment Benefits

Plan Description

The Authority provides retirement healthcare benefits under the Healthcare Benefit Plan to Retirees (the Plan) pursuant to collective bargain agreements. The Plan is administered by the Authority. The benefit consists on a fixed maximum monthly payment (annuity) to cover medical expenses. Based on the Plan's features and functionality, and for the purpose of the actuarial valuation, it has been identified as a single-employer defined benefit healthcare plan. Participants groups covered are employees under Collective Labor Agreement with "Unión Independiente Auténtica" (UIA), employees under Collective Labor Agreement with "Hermandad Independiente de Empleados Profesionales de la Autoridad de Acueductos y Alcantarillados" (HIEPAAA) and employees under Managers' Regulation, all of which are Authority employees. All employees with more than twenty (20) years of rendered service within the Authority are eligible for the healthcare benefit upon retirement age. Normal retirement age is as follows:

- ▶ For those employees employed by the Authority before March 30, 1990, normal retirement age will be at sixty-one (61) years old.
- ▶ For employees employed by the Authority on March 30, 1990 and before July 1, 2013, normal retirement age will be at sixty-five (65) years old.
- ▶ For the employees hired by the Authority after July 1, 2013, normal retirement age will be at sixty-seven (67) years old.

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

Funding Policy

The contribution requirements of the Authority are established and may be amended, by the Authority's Board of Directors. The benefits are paid directly by the Authority to the retirees at a rate of a maximum of \$125 per month per retiree. The Plan is financed on a pay-as-you-go basis and the amount contributed during fiscal years ended June 30, 2014 and 2013 was approximately \$2.9 million, which is in accordance with the funding policy. There is no contribution requirement for plan members.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

17. Other Postemployment Benefits (continued)

Annual OPEB costs and Net OPEB obligation

The Annual Pension Cost (APC) and the Annual Required Contribution (ARC) were computed as part of an actuarial valuation performed as of June 30, 2013, in accordance with parameters of GASB Statement No. 45 based on current years' demographic data. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (UAAL) over a period of 12 years.

The annual required contribution estimated for the years ended June 30, 2014 and 2013 amounted to (in thousands):

	2014	2013
Annual Required Contribution (ARC):		
Normal costs	\$ 2,314	\$ 2,379
Amortization of initial UAAL	2,739	3,224
Amortization of loss	4,072	3,556
GASB Statement No. 45 Annual Required Contribution	\$ 9,125	\$ 9,159

OPEB costs components for the years ended June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013
Annual OPEB Costs		
ARC for fiscal year	\$ 9,125	\$ 9,159
Interest on Net OPEB Obligation	546	343
ARC Amortization Adjustment	(2,579)	(1,621)
Total Annual OPEB Costs	\$ 7,092	\$ 7,881

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Notes to Financial Statements (continued)

June 30, 2014

17. Other Postemployment Benefits (continued)

Annual OPEB costs and Net OPEB obligation (continued)

The net OPEB obligation change for the years ended June 30, 2014 and 2013 is as follows (in thousands):

	2014	2013
Change in net OPEB obligation		
Net OPEB obligation, July 1, 2013	\$ 28,141	\$ 22,652
Total annual OPEB costs	7,092	7,881
Actual benefit payments	(2,903)	(2,392)
Net OPEB obligation, June 30, 2014	\$ 32,330	\$ 28,141

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheets as of June 30, 2014 and 2013.

Funded Status

Funded status of the plan as of June 30, 2014 and 2013, the most recent actuarial valuation date, is as follows (in thousands):

	2014	2013
Unfunded Actuarial Accrued Liability (UAAL):		
Active employees	\$ 31,196	\$ 32,311
Retirees	40,831	40,733
Actuarial accrued liability	72,027	73,044
Actuarial value of assets	—	—
UAAL	\$ 72,027	\$ 73,044

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

17. Other Postemployment Benefits (continued)

Actuarial Assumptions

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

Economic Assumptions

Discount Rate

The discount rate considered for years ended June 30, 2014 and 2013 was 2.0%. For fiscal year 2014, a 3-year average of the U.S. Treasury Bond 10-year term investments represents the Authority's expected long-term return on internal assets used to finance the payment of plan benefits.

Medical Increase Rate

As the retirement healthcare benefit is fixed, such that it will not increase the obligation under the plan (regardless of the claim experience) without negotiation of a new contract with the unions or an express Board of Directors' approval, the medical increase rate was zero percent for the years ended June 30, 2014 and 2013. If the fixed benefit level does indeed increase sometime in the future (by negotiation or plan amendment), the higher obligation will be recognized when the new contract or amendment is adopted.

Turnover

For the years ended June 30, 2014 and 2013, the turnover table used for the valuation was the Standard Hewitt Withdrawal Table for Hourly Union Employees – five (5) years of service select period.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

17. Other Postemployment Benefits (continued)

Healthy Mortality

The RP-2000 Combined Healthy Mortality Table projected to 2018 by Scale AA was used for the valuation of the benefit granted by the plan.

Disability Table

The Hunter disability table was used for the valuation.

Actuarial Cost Method

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

Amortization of Initial UAAL

Period

The initial UAAL will be amortized in a 12-year period based on the average future years of service of the active population, starting with the fiscal year ended June 30, 2008. The years of service projection considers multiple decrement tables and the latest age of retirement, considered to be 65 years. The open amortization criteria were used for the valuation.

Method

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

18. Labor Union Contracts

The collective bargaining agreement with the HIEPAAA union, which covers approximately 162 professional employees, was signed effective May 31, 2012 until June 30, 2016.

The collective bargaining agreement with the UIA union, which covers approximately 3,521 blue-collar and clerical employees, was signed effective January 1, 2012 until December 31, 2015.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

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

The Authority developed the Superaqueduct, as part of the infrastructure of the water intakes and the interconnections tanks in the distribution system, along the PR North Coast route, from Arecibo to Bayamon. On July 19, 2011, Thames-Dick agreed to cancel the Master Agreement and transferred to the Authority the responsibility of the operation and administration of the North Coast Aqueduct. During fiscal year 2012, the Authority signed an agreement with Caribbean Water Specialist Corp. and pays a management fee for the operation, security, and for the environmental and regulatory compliance (water quality) for all the operations under the contract of the North Coast Aqueduct. On October 1, 2013, the Authority signed a contract agreement with CH2 Hill Puerto Rico for the operation and maintenance of the Superaqueduct for a 12-month period, contract may be renewed on an annual basis up to five years. The cost incurred under the contract is reported under the caption of *Service Contract – Superaqueduct* (\$3.9 million and \$5.7 million for the years ended June 30, 2014 and 2013, respectively). All other operational costs associated with the operation of the system are captioned in their respective expense category.

20. Commitments and Contingencies

Environmental Matters

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

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

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

As part of the agreement, PRASA pays stipulated penalties for pump station bypass events on a quarterly basis. The penalty calculations are based on the pumping capacity of the pump station and the time taken to correct the deficiency causing the bypass event. The amount of penalties during fiscal years 2014 and 2013 was approximately \$0.3 million.

- On June 22, 2006, the Authority entered into a consent decree (Civil Action No. 06-1624) with EPA that requires the Authority to implement system-wide remedial measures at all of the wastewater treatment plants operated by the Authority. The decree establishes deadlines for the compliance with the conditions set forth in the agreement and stipulates penalties for violation of any of those deadlines. The Authority was assessed a stipulated civil penalty of \$1 million which was paid during fiscal year 2008. This penalty was assessed by the Court as payment for the discharge permit violations of several treatment facilities to the Clean Water Act.

The agreement also required the Authority to deposit in an escrow account with the GDB an additional civil penalty in the amount of \$3 million. These funds are to be used for providing sewer service to a community that has not been connected to the Authority's sanitary sewer system. As results of the discussion between PRASA and EPA, it was decided to connect The Lago La Plata Community Supplemental Environmental Project. The project consists of the installations of 7,886 meters of sanitary sewer systems, composed by gravity and forceline system and will benefit La Plata community, 230 house connections, the community school and the Coliseum for an estimated cost of \$4.1 million and has an expected date of the project completion by October 2014.

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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

As part of the agreement, PRASA pays stipulated penalties on a yearly basis for exceedances to each of PRASA's facilities to their individual discharge permits. The penalty calculations are based on frequency of the exceedances as well as the percentage of the exceedances with its respective limit. The amount of penalties during fiscal years 2014 and 2013 were approximately \$0.6 million and \$0.5 million, respectively. These penalty payments are deposited into an escrow account from which a fraction of the deposited amount can be reimbursed to the Authority based on completion of specific projects and initiatives.

- On May 25, 2006, the Authority entered into a plea agreement with the U. S. Department of Justice related to violations of the Clean Water Act, as amended, Title 33, USC, Sections 11311(a) and 1319(c)(2)(A). As part of the agreement (Criminal Case No. 06-CR--00202-001), the Authority paid a \$9 million fine. This penalty was assessed by the Court as payment for the discharge permit violations of several treatment facilities of the Clean Water Act. The Authority was placed on probation for a period of five years, which expired on April 19, 2012. As part of the probation, the Authority had to comply with several special conditions, such as: (i) upgrade the collection and wastewater treatment system in the Ponce de León Avenue area of San Juan for a cost of not less than \$10.0 million to prevent direct discharges to the Martin Peña Channel, (ii) upgrade nine waste water treatment plants for a cost not less than \$109.0 million, and (iii) comply with the consent decree signed by the Authority with the U.S. Government on June 22, 2006. The plea agreement also established stipulated penalties for violation of any of the deadlines or performance standards set forth in the agreement. As of today, the Authority is in compliance with the deadlines and requirements of this Consent Order and no penalties have been paid. The probation period expired on April 2012.
- On December 15, 2006, an agreement (Civil Case No. KPE 2006-0858) was signed between the Authority and the Department of Health of the Commonwealth related to violations of the Safe Drinking Water Act (SDWA), as amended. The agreement was preliminarily approved by the supervising court on March 15, 2007 and it was amended and finally approved by that court on June 20, 2008. The Authority agreed to implement a work plan to remediate the violations, establish preventive and mitigation measures, and execute a preventive maintenance program for the purpose of meeting the requirements of the SDWA. This Act requires the compliance with parameters of water quality and treatment techniques in the

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

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

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

During fiscal years ended June 30, 2014 and 2013, the penalties amounted approximately \$0.1 million and \$0.6 million, respectively. The Authority deposited \$0.1 million in an escrow account. The deposit in the escrow account is for parameters exceedances, and will be used for compliance projects with the approval of the Department of Health.

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

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

The total amount of penalties paid under this agreement during the fiscal years 2014 was approximately \$0.2 million. Stipulated penalties must be paid by the Authority for failing to comply with remedial measures deadlines, permit limit exceedances or fail to submit deliverables or Discharge Monitoring Reports.

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

Risk Management

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

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Risk Management (continued)

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Real and personal property:		
Windstorm	Up to \$32.5 million per event, with a minimum of \$25.0 million	\$150.0 million per event
Flood	Up to \$28 million per event, with a minimum of \$25.0 million	\$300.0 million per event
Earthquake	Up to \$32.5 million per event, with a minimum of \$25.0 million	\$300.0 million per event
All other	\$25.0 million per occurrence	\$150.0 million per event
Automobile	—	\$1.0 million per occurrence
Comprehensive general liabilities	\$100 thousand per occurrence	\$1.0 million per occurrence \$2.0 million per aggregate
Umbrella liability		
First Excess General liability and automobile	Retention \$1.0 million	In excess of \$20.0 million up to \$20.0 million
Second Excess General liability and automobile	—	From \$20.0 million to \$40.0 million
Pollution Liability	\$250 thousand per occurrence	\$5.0 million
Crime	\$10 thousand per occurrence	From \$500 thousand up to \$1.0 million

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

Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Risk Management (continued)

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Officers and Directors	\$200 thousand per occurrence	\$20.0 million
First Excess Directors and Officers	—	Additional \$10.0 million
Travel and Accident	—	\$500 thousand per occurrence
Accident and Health Divers	—	\$2.5 million aggregate \$250 thousand per occurrence
EPLI	\$100 thousand per occurrence	\$1.7 million aggregate \$5.0 million
Excess EPLI	—	Additional \$5.0 million

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

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Risk Management (continued)

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

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Comprehensive general liability:		
General liability	\$10 thousand per occurrence	\$2.0 million per occurrence \$4.0 million aggregate
First excess liability	\$10 thousand per occurrence	\$25.0 million per occurrence \$50.0 million aggregate
Second excess liability	—	\$25.0 million per occurrence \$50.0 million aggregate
Builder's Risk	\$20 thousand theft \$100 thousand - atmospheric events	\$100.0 million per occurrence
Contractor's Pollution Liability	\$25 thousand per occurrence	\$25.0 million per occurrence \$25.0 million aggregate
Professional Liability	\$250 thousand per occurrence	\$25.0 million per occurrence \$50.0 million aggregate

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

Construction Projects

The Authority enters in construction projects for the replacements or expansion of its facilities. As of June 30, 2014 and 2013, there were outstanding commitments for projects in process for approximately \$124.2 million and \$88.3 million, respectively.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the years ended June 30, 2014 and 2013, the Authority incurred approximately \$4.7 million and \$4.2 million, respectively, in rent expense.

Future minimum noncancelable lease payments on existing operating leases at June 30, 2014, which have an initial term of one year or more, are as follows (in thousands):

2015	\$ 3,269
2016	2,913
2017	2,590
2018	2,358
2019	1,479
2020 - 2024	3,668
2025 - 2029	1,771
	<u>\$ 18,048</u>

Litigation

The Authority is the defendant in lawsuit filed by customers alleging that the Authority has over billed them due to the methodology used to estimate consumption. The case in which plaintiffs requested a certification of the suit as a class action and seek recovery of damages, and an injunction enjoining the Authority from continuing to bill using the current methodology. The case is Fernando Toro, et al. v. Autoridad de Acueductos y Alcantarillados.

In the Toro case, the class certification hearings took place in the month of June 2011. The parties presented their evidence and the Judge determined the certification to a class action. At the present time, the Authority appealed the class action certification and is expecting the Court decision on the request. However, after evaluating the evidence presented in the class certification hearings, the Authority's potential exposure from this lawsuit is unlikely and, as such, no liability is being reported on the financial statements.

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

Notes to Financial Statements (continued)

June 30, 2014

20. Commitments and Contingencies (continued)

Litigation (continued)

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

21. Adoption of GASB No. 65 and Prior Period Restatement

Adoption of GASB No. 65

During fiscal year ended June 30, 2014, GASB No.65 “Items Previously Reported as Asset and Liabilities” became effective, which requires recording the non-insurance portion of deferred debt issuance costs previously presented as Other Assets in the Authority’s balance sheets, as operating expenses, and proper classification of certain items previously reported as assets or liabilities as deferred outflows of resources and deferred inflows of resources. As a result of the implementation of GASB 65, starting with the 2014 fiscal year, all debt issuance costs will be presented as expense during the year they are incurred.

Prior Period Restatement

During the course of preparing the 2014 financial statements, the Authority noted an understatement on capital assets being depreciated and overstatement on prior year net position due to unclosed construction in progress. As consequence, \$274.2 million in a correcting entry was made in the 2013 prior period financial statements to transfer from construction in progress to capital assets being depreciated. As part of the prior year adjustment, a \$43.6 million restatement on beginning net position for 2013 was recorded related to depreciation expense.

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

Notes to Financial Statements (continued)

June 30, 2014

21. Adoption of GASB No. 65 and Prior Period Restatement (continued)

The effect of the adoption of GASB No. 65 and the prior period adjustment on balances previously reported as of and for the year ended June 30, 2013, is as follows.

	2013 Balance as Previously Reported	Prior Period Restatement	GASB 65 Adjustment	2013 Balance as Restated
Capital assets reclassification				
Capital assets:				
Capital assets being depreciated	\$ 9,499,207	\$ 274,198	\$ –	\$ 9,773,405
Accumulated depreciation and amortization	(3,246,296)	(56,115)	–	(3,302,411)
Land and other depreciable assets	71,188	–	–	71,188
Construction in progress	1,096,369	(274,198)	–	822,171
Total capital assets, net	7,420,468	(56,115)	–	7,364,353
Deferred outflows of resources				
Deferred debt issuance cost	63,335	–	(63,335)	–
Deferred outflows of resources	–	–	39,343	39,343
Current liabilities				
Bonds payable	13,471	–	3,745	17,216
Noncurrent liabilities				
Bonds payable	4,509,255	–	35,598	4,544,853
Change in net position				
Net position, <i>beginning of the year</i>	2,998,915	(43,572)	(64,127)	2,891,216
Net position, <i>end of the year</i>	2,539,475	(56,115)	(63,335)	2,420,025

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

Notes to Financial Statements (continued)

June 30, 2014

21. Adoption of GASB No. 65 and Prior Period Adjustment (continued)

	2013	2012 and prior	Total restatement
Depreciation expense, <i>as reported</i>	\$ 232,191	\$ 211,127	
Restatement	12,543	43,572	\$ 56,115
Depreciation expense, <i>as restated</i>	\$ 244,734	\$ 254,699	
GASB 65 restatement	\$ (63,335)	\$ (64,127)	
Depreciation restatement	(56,115)	(43,572)	
Net position, <i>as previously reported</i>	2,539,475	2,998,915	\$ (459,440)
Net position, <i>as restated</i>	\$ 2,420,025	\$ 2,891,216	\$ (471,191)

Required Supplementary Information

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

Required Supplementary Information
Schedule of Funding Progress for Postemployment Healthcare Benefits

(In thousands)

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability	Funded Ratio	Annual Covered Payroll	Percentage of Covered Payroll
June 30, 2014	\$ —	\$ 72,027	\$ 72,027	—%	\$148,131	49%
June 30, 2013	\$ —	\$ 73,044	\$ 73,044	—%	\$149,613	49%
June 30, 2012	\$ —	\$ 71,703	\$ 71,703	—%	\$163,753	44%

See accompanying independent auditors' report.

Supplemental Schedule

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

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

Years Ended June 30, 2014 and 2013

(In thousands)

	2014	2013
Revenues		
Service revenues (cash basis)	\$ 1,036,725	\$ 746,370
Other Income	4,313	6,465
Developers Contributions	4,501	6,537
Transfer to Surplus Fund	(93,000)	-
Operating revenues (cash basis)	952,539	759,372
Budgetary Reserve Fund	-	145,000
Total authority revenues	952,539	904,372
Operating expenses:		
Payroll and payroll related	291,639	272,092
Electricity	166,720	209,168
Other operating expenses	251,532	217,614
Total net operating expenses	709,891	698,874
Non cash reserve adjustments	39,927	-
Adjusted operating expenses	669,964	698,874
Total net revenues per MAT	\$ 282,575	\$ 205,498
Debt service coverage calculation:		
Operating revenues	\$ 952,539	\$ 759,372
Senior debt (net of funds available in the Senior Bond Fund of \$43.6 million)	193,611	90,600
<i>Accumulated coverage ratio (Min 2.5x) - Section 7.01 (i) MAT</i>	4.92	8.38
Senior subordinated debt	-	-
<i>Accumulated coverage ratio (Min 2.0x) - Section 7.01 (ii) MAT</i>	4.92	8.38
All bonds and other system indebtedness	193,611	90,600
<i>Accumulated coverage ratio (Min 1.5x) - Section 7.01 (iii) MAT</i>	4.92	8.38
Rate covenants:		
Authority revenues	\$ 952,539	\$ 904,372
All debt plus current expenses	944,850	864,866
<i>Accumulated coverage ratio (Min 1.0x) - Section 7.01 (iv) MAT</i>	1.01	1.05

Other Report



Ernst & Young LLP
Plaza 273, Suite 1000
273 Ponce de León Avenue
San Juan, PR 00917-1951

Tel: +1 787 759 8212
Fax: +1 787 753 0808
ey.com

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

The Board of Directors
Puerto Rico Aqueduct and Sewer Authority

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Puerto Rico Aqueduct and Sewer Authority (the Authority) as of and for the year ended June 30 2014, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated March 31, 2015.

Internal Control Over Financial Reporting

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

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

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

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.

Finding No.:2014-001 – Financial Statements

Topic

The Authority's lack of control over the transfer of closed projects in construction in progress and assets being depreciated.

Category

Internal Control

Criteria

A sound system of internal controls is essential in enabling the Authority to prepare timely and accurate financial statements by helping ensure all financial transactions are properly recorded, appropriate supported and subject to supervisory review.

Condition Found

During our audit procedures, we selected a number of open projects in the construction in process (CIP) account as of June 30, 2014. For projects recorded in the construction in process account we verified that the project was open and in progress. During our review, we noted that approximately \$274.1 million of open projects in CIP were completed in fiscal 2014 and previous years and were not closed and transferred to assets being depreciated as of June 30, 2014. Consequently, there was approximately \$76.6 million in depreciation expense not recorded as of June 30, 2014. Of this amount, approximately \$56.1 million in unrecorded depreciation related to prior periods.

Cause

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

Effect

Delays in the verification and capitalization of CIP open projects between the finance and infrastructure departments resulted in several audit adjustments recorded in the Authority's financial statements as of and for the year ended June 30, 2014.

Recommendation

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

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

Management's Response

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

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

Compliance and Other Matters

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

The Authority's Responses to the Findings

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



Purpose of this Report

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

Ernst + Young LLP

March 31, 2015

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this report.

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