

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Basic Financial Statements and  
Required Supplementary Information

June 30, 2019

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
 Puerto Rico Safe Drinking Water  
 Treatment Revolving Loan Fund

Report on the Financial Statements

We have audited the accompanying statement of net position of the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (“the Revolving Fund”) as of June 30, 2019 and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, which collectively comprise the Revolving Fund’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

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

Auditors’ Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors’ 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 Revolving Fund’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 Revolving Fund’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 the Revolving Fund, as of June 30, 2019, and the related changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### Emphasis of Matters

#### Uncertainty and Liquidity Risk

As further discussed in Note 3 to the basic financial statements, the Revolving Fund has recognized at June 30, 2019 significant loss provisions with respect to its loans to the Puerto Rico Aqueduct and Sewer Authority (PRASA) of approximately \$38.6 million. This loss event, together with past credit losses in the Revolving Fund's deposits with the Government Development Bank of Puerto Rico (GDB), have brought a significant reduction in the Revolving Fund's net position and liquidity, as well as temporarily halting the disbursement of funds for the construction of drinking water infrastructure to PRASA, to the point of raising substantial doubt about the Revolving Fund's ability to continue serving the purposes of the safe drinking water treatment revolving loan program, especially as it had been partially inactive since then.

As further disclosed in Notes 3 and 12 to the basic financial statements, in response to the liquidity concerns referred to in the previous paragraph, the Commonwealth of Puerto Rico (the Commonwealth) recapitalized the Revolving Fund, by making a \$53.3 million contribution to the Revolving Fund during December 2018, deposited in a separate trust account of new creation, from which the Revolving Fund would now be able to resume its normal operations for which it was created. With respect to the collectability of the loans, on July 26, 2019, the Commonwealth, PRASA and the Revolving Fund finalized the restructuring of PRASA's obligations, which would permit PRASA to resume its payments, although in a restructured manner, to the Revolving Fund.

Future capitalization grants are dependent on the availability of funds from the Commonwealth to match a required percentage under Federal Law; which in turn depends on budgetary appropriations made by the Legislature of the Commonwealth and the certification of such allocations by the Financial Oversight and Management Board for Puerto Rico, which actions are beyond the control of the Revolving Fund. Notwithstanding, the aforementioned remediating activities already in effect alleviate the substantial doubt about the Revolving Fund's ability to continue serving the purposes of the safe drinking water treatment revolving loan program.

To the Board of Directors of  
Puerto Rico Safe Drinking Water  
Treatment Revolving Loan Fund  
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Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 8 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, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries 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 basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



FPV & Galindez

San Juan, Puerto Rico  
September 13, 2021  
License No. LLC-322  
Expires December 1, 2023

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Management's Discussion and Analysis (Unaudited)

June 30, 2019

As financial management of the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the Safe Drinking Water State Revolving Fund or SDWRF), we offer readers of the Revolving Fund's financial statements this narrative overview and analysis of the Revolving Fund's financial performance during the fiscal year ended June 30, 2019. This discussion and analysis is designed to assist the reader in focusing on the significant financial matters and activities and to identify any significant changes in the net position of the Revolving Fund. We encourage readers to consider the information presented here in conjunction with the basic financial statements as a whole, which follow this section.

Financial Highlights

- The Revolving Fund's restricted net position increased approximately by \$57.5 million or 39% over the course of the year's operations mainly resulting from contributions from the Commonwealth of Puerto Rico of approximately \$53.3 million and a reversal in the provision for loan losses of approximately \$3.5 million. Management's analysis of the allowance for loan losses showed a reduction in the required reserves.
- Operating income was approximately \$3 million for fiscal year 2019, an increase of approximately \$715 thousand when compared to the prior year.
- Grants and contributions received experienced a net increase of approximately \$54 million when compared to prior year, mostly related to the contribution received from the Commonwealth amounting to \$53.3 million.
- Loan receivable for capital improvements programs experience a net increase of approximately \$173 thousand when compared to the previous year, which is composed of collections of outstanding loans amounting to approximately \$3.3 million and a decrease in the allowance for loan losses amounting to approximately \$3.5 million during the year ended on June 30, 2019. There were no loan disbursements made by the Revolving Fund during fiscal year 2019.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Revolving Fund's basic financial statements, which are comprised of the basic financial statements and the notes to the basic financial statements. Since the Revolving Fund is comprised of a single enterprise fund, no fund level financial statements are shown.

Basic Financial Statements

The basic financial statements are designed to provide readers with a broad overview of the Revolving Fund's finances, in a manner similar to a private-sector business. The statement of net position presents information on all of the Revolving Fund's assets and liabilities, with the difference between the two reported as net position. Net position increase when revenues exceed expenses. Increases in assets without a corresponding increase to liabilities result in increased net position, which indicate an improved financial position.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Management's Discussion and Analysis (Unaudited) – (continued)

June 30, 2019

The statement of revenues, expenses and changes in net position presents information showing how an entity's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event occurs, regardless of timing of related cash flows.

The last of the required financial statements is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and capital and non-capital financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

Financial Analysis

Net position may serve, over time, as a useful indicator of whether a governmental entity's financial position is improving or deteriorating. In the case of the Revolving Fund, assets exceeded liabilities by approximately \$206.3 million as of June 30, 2019. This represents an increase of approximately \$57.5 million or 39% over net position as of June 30, 2018. The total amount of net position is restricted as it only serves the purpose provided by the enabling legislation of providing loans and financing for drinking water infrastructure facilities. As of June 30, 2019, all loans and commitments have been granted to the Puerto Rico Aqueduct and Sewer Authority (PRASA).

For fiscal year 2019, the Revolving Fund's management established an allowance for loan losses based on, among others, the terms and conditions of the PRASA's debt restructuring agreement discussed in Note 12 to the basic financial statements. Since the fiscal year 2017, management has recognized in the basic financial statements the effects of these subsequent events based on information available prior to the issuance of such financial statements. The allowance for loan losses on the troubled debt restructuring was based on management best estimate of the present value of expected debt service payments discounted at the loans' original effective interest rate. As part of the PRASA's debt restructuring, the Commonwealth guaranty related to all the original financing agreements was terminated and any future right to the guaranty was waived. The notes are on parity with PRASA's senior bonds and other senior indebtedness.

The operation of the Revolving Fund is subject to the capital financing requirements of PRASA, and/or any other qualifying entity, and therefore, loan origination activity will be determined on an annual basis, depending upon PRASA's and/or any other qualifying entity's needs.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Management's Discussion and Analysis (Unaudited) – (continued)

June 30, 2019

Condensed financial information on assets, liabilities, and restricted net position is presented below (in thousands):

	June 30,		Change	
	2019	2018	Amount	Percent
Assets:				
Cash and cash equivalents	\$ 60,000	\$ 2,886	\$ 57,114	1979.00%
Interest receivable	98	-	98	100.00%
Loans receivable	<u>146,252</u>	<u>146,079</u>	<u>173</u>	<u>0.12%</u>
Total current assets	206,350	148,965	57,385	38.52%
Liabilities - accounts payable	<u>53</u>	<u>145</u>	<u>(92)</u>	<u>(63.45%)</u>
Net position - restricted	<u>\$ 206,297</u>	<u>\$ 148,820</u>	<u>\$ 57,477</u>	<u>38.62%</u>

Cash at June 30, 2019 amounted to approximately \$60 million resulting in an increase of approximately \$57.1 million from approximately \$2.8 million as of June 30, 2018, or an increase of 1979%, attributed mostly to a Contribution made by the Commonwealth of Puerto Rico amounting to \$53.3 million and the escrows deposits made by PRASA in accordance with the loan forbearance agreements. The increase in loans receivable was due to the reversal in the allowance for loan losses of approximately \$3.5 million during 2019. Consequently, the net position increased by approximately \$57.5 million primarily due to the release of provision for loan losses amounting to approximately \$3.5 million and a contribution received during the year from the Commonwealth amounting to approximately \$53.3 million.

Condensed financial information on revenues, expenses, and change in net position is presented below (in thousands):

	June 30,		Change	
	2019	2018	Amount	Percent
Operating recovery, net	\$ 2,980	\$ 2,265	\$ 715	31.57%
Non-operating revenues				
Interest income on deposits	649	9	640	7111.11%
Contributions	<u>53,848</u>	<u>520</u>	<u>53,328</u>	<u>10255.38%</u>
Change in restricted net position	57,477	2,794	54,683	1957.16%
Net position - beginning of year	<u>148,820</u>	<u>146,026</u>	<u>2,794</u>	<u>1.91%</u>
Net position - end of year	<u>\$ 206,297</u>	<u>\$ 148,820</u>	<u>\$ 57,477</u>	<u>38.62%</u>



Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Management's Discussion and Analysis (Unaudited) – (continued)

June 30, 2019

The change in net position increased by approximately \$57.477 million when compared to the previous year. The positive variance results principally from a contribution received from the Commonwealth amounting to approximately \$53.3 million and a release of provision for loan losses of approximately \$3.5 million.

Currently Known Facts

Restoration of Funds from the Commonwealth

The Commonwealth, with the approval of the Oversight Board, included in its budget for fiscal year 2019, \$194.5 million to be transferred to the State Revolving Funds (SRFs) in restitution of the deposits lost because of GDB's insufficient liquidity. The SRFs had approximately \$194.5 million that was on deposit with GDB and frozen during fiscal year 2016.

The U.S. Environmental Protection Agency (EPA) requested the transfer of said funds in a lump sum as soon as appropriate since these funds would go a long way in helping to stabilize the SRFs and enable them to provide significant financial assistance to Puerto Rico communities in addressing critical water and waste-water infrastructure problems for the maximum benefit to the people. On November 21, 2018 the Oversight Board agreed and authorized the disbursement, on or before December 31, 2018, of the \$194.5 million (\$141.2 million on behalf of the on behalf of the Revolving Fund and \$53.3 million on behalf of the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, respectively).

On December 19, 2018, the Fiscal Agency and Financial Advisory Authority (FAFAA) requested to the Treasury Department and the Office of Management and Budget the release and transfer of such funds, which are currently deposited in their respective Trust account in custody of Banco Popular de Puerto Rico.

PRASA Debt's Restructuring

The Commonwealth of Puerto Rico reached an agreement with the Environmental Protection Agency (EPA) to restructure some \$596 million in PRASA debt with the SRF's, of which approximately \$192.5 million pertained to the Revolving Fund. PRASA and the Commonwealth reached an understanding with the federal agency's Water Pollution Control and Drinking Water State Revolving Fund programs (SRF). The agreements modify the economic terms of approximately \$596 million in outstanding SRF loans, eliminate the Commonwealth's guaranty of such debt, and designate the new federal debt as parity senior debt with PRASA's other senior debt pursuant to the terms of PRASA's existing Master Agreement of Trust. The agreement ended the need for continued forbearance agreements related to the federal debt and alleviated certain uncertainties about PRASA's future. Refer to Note 12 to the basic financial statements for further information.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Management's Discussion and Analysis (Unaudited) – (continued)

June 30, 2019

Mitigating Factors to Going Concern

Future capitalization grants are dependent on the availability of funds from the Commonwealth to match a required percentage under Federal Law; which in turn depends on budgetary appropriations made by the Legislature and the certification of such allocations by the Oversight Board (see Note 3), which actions are beyond the control of the Revolving Fund. Notwithstanding, the remediating activities already in effect alleviate the substantial doubt about the Revolving Fund's ability to continue serving the purposes of the safe drinking water treatment revolving loan program. The Department of Health under the Commonwealth has always complied with the matching requirement and will continue directing its exertions towards complying with it.

Requests for Information

This financial report is designed to provide those interested with a general overview of the Revolving Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, P.O. Box 42001, San Juan, Puerto Rico, 00940-2001.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Statement of Net Position

June 30, 2019

Assets

Current assets

Cash and cash equivalents	\$ 59,999,321
Interest receivable	98,238
Loans receivable from Puerto Rico Aqueduct and Sewer Authority, net of allowance for loan losses of \$32.3 million	<u>277,778</u>
Total current assets	60,375,337

Non current assets - Loans receivable from

Puerto Rico Aqueduct and Sewer Authority, net of allowance for loan losses of \$6.4 million	<u>145,974,429</u>
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Total assets	<u><u>206,349,766</u></u>
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Liabilities and Net Position

Liabilities - accounts payable	<u>53,336</u>
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Net position - restricted	<u>206,296,430</u>
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Total liabilities and net position	<u><u>\$ 206,349,766</u></u>
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See notes to basic financial statements

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended June 30, 2019

Operating (recovery) expenses:	
Release of provision for loan losses	\$ (3,507,000)
General and administrative	<u>526,679</u>
Total operating recovery, net	<u>(2,980,321)</u>
Operating income	<u>2,980,321</u>
Non-operating revenues:	
Interest income on deposits	648,717
Contributions from Commonwealth of Puerto Rico	53,316,156
Contributions from Environmental Protection Agency	<u>531,617</u>
Total non-operating revenue	<u>54,496,490</u>
Change in net restricted position	57,476,811
Net position - beginning of year	<u>148,819,619</u>
Net position - end of year	<u>\$ 206,296,430</u>

See notes to basic financial statements

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Statement of Cash Flows

For the Year Ended June 30, 2019

Cash flows from operating activities:	
Cash paid for general and administrative expenses	\$ (618,758)
Principal collected on loans	<u>3,333,333</u>
Net cash provided by operating activities	<u>2,714,575</u>
Cash flows from investing activities -	
Interest collected on deposits	<u>550,479</u>
Cash flows from non-capital financing activities	
Contributions received from the Commonwealth of Puerto Rico	53,316,156
Contributions received from the Environmental Protection Agency	<u>531,617</u>
Net cash provided by non-capital financing activities	<u>53,847,773</u>
Net increase in cash	57,112,827
Cash and cash equivalents - beginning of year	<u>2,886,494</u>
Cash and cash equivalents - end of year	<u>\$ 59,999,321</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 2,980,321
Adjustments to reconcile operating income to net cash provided by operating activities:	
Release of provision for loan losses	(3,507,000)
Decrease in loans receivable from Puerto Rico Aqueduct and Sewer Authority	3,333,333
Decrease in accounts payable	<u>(92,079)</u>
Net cash provided by operating activities	<u>\$ 2,714,575</u>

See notes to basic financial statements

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements

June 30, 2019

Note 1 - Reporting Entity

Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the Revolving Fund) was created by Act 32 of the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) on July 7, 1997. The Revolving Fund was constituted separately and independently from any other funds or resources of the Commonwealth. It is presented as an enterprise fund of the Commonwealth.

The Revolving Fund is administered, pursuant to Act 5 of July 21, 1977, as amended (the Act 5), by the Puerto Rico Department of Health (the DOH). Pursuant to the Act 5, the DOH, on behalf of the Commonwealth, is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA). DOH, Puerto Rico Infrastructure Financing Authority (PRIFA), Puerto Rico Aqueduct and Sewer Authority (PRASA), and the Fiscal Agency and Financial Advisory Authority (FAFAA) entered into a memorandum of understanding under which each party has agreed to assume specific responsibilities in connection with the operations of the Revolving Fund.

On June 30, 2017, PRASA, PRIFA, Puerto Rico Department of Natural and Environmental Resources (DNER) and the Puerto Rico Department of Health (DOH), entered into an Escrow Deposit Agreement (Escrow Agreement) with Banco Popular de Puerto Rico (BPPR or Escrow Agent). The Escrow Agreement was established, among other things, (1) to account for irrevocable escrow accounts, (2) hold deposit of the escrowed assets and (3) to apply such escrowed assets solely in accordance with the escrow agreement.

The Escrow Agreement emerged as part of and as a condition to the second amendment to the Forbearance Agreement as PRASA agreed to execute certain minimum payments to PRIFA for the sole benefit of the Revolving Fund. However, as a result of the uncertainty surrounding the impact of the Hurricanes Irma and María on PRASA's revenues and expenditures and the timing of receipt of federal grants or other funding, PRASA needed to preserve sufficient liquidity for operations and expenditures related to restoring its infrastructure, and therefore requested that PRIFA, DNER, DOH and the EPA agree to waive the requirement of the payments due on November 1, 2017 and December 1, 2017, included in the Second Amendment.

Pursuant to the operating agreements with EPA, PRIFA is required to establish trust fund accounts to hold separate and apart from its assets or those of any of the agencies of the Commonwealth, in which it will deposit all funds received from borrowers of the Revolving Fund funds. PRASA will not have and will not exercise any dominion or control over the escrowed assets until the date that the Escrow Agent receives a certificate of compliance with the operating agreements with EPA and duly constituted in accordance with the laws of the Commonwealth.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 1 - Reporting Entity – (continued)

Amendments to the Operating Agreements and Memorandum of Understanding-Incorporation into Trust Agreement

Effective September 18, 2018, DOH and EPA entered into a revised Drinking Water State Revolving Fund Operating Agreement (the Revolving Fund Operating Agreement). On September 18, 2018, PRIFA and DOH entered into an amendment to the December 27, 2016 memorandum of understanding between PRIFA and DOH attached to and referenced in the Revolving Fund Operating Agreement.

DOH, PRIFA and FAFAA, with the consent of EPA, have agreed to incorporate into the Revolving Fund Operating Agreement, The Trust Agreement (the Trust Agreement) with BPPR, as Trustee (the Trustee), pursuant to which the Trustee shall receive all capitalization grant funds, investment earnings and funds recovered under the Commonwealth Fiscal Plan related to the Revolving Fund, and set them aside in a Trust separate and apart from any and all proprietary funds of PRIFA, DOH, and the Commonwealth, its agencies and instrumentalities, all in accordance with the further terms and conditions provided in the Trust Agreement. The Trust Agreement between DOH, PRIFA and Banco Popular of Puerto Rico was executed on December 18, 2018.

Note 2 - Summary of significant accounting policies

The accounting and reporting policies of the Revolving Fund conform to Accounting Principles Generally Accepted in the United States of America (GAAP) for governments, as prescribed by the Governmental Accounting Standards Board (GASB).

During the fiscal year ended on June 30, 2019, certain governmental accounting pronouncements became effective, none of which had any impact in the results of the operations or in the presentation of the financial statements of the Revolving Fund.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of changes in net position and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Following is a description of the Revolving Fund's most significant accounting policies:

Measurement Focus, Basis of Accounting, and Financial Statements Presentation

The Revolving Fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows.

The statement of net position and the statement of revenues, expenses, and changes in net position report information on all activities of the Revolving Fund. The Revolving Fund's activities are distinguished as proprietary activities. The Revolving Fund's activities generally are financed through intergovernmental revenues, other non-exchange revenues and interest income from its loans and deposits. Following is a description of the Revolving Fund's financial statements.

The statement of net position presents the Revolving Fund's assets and liabilities, with the difference reported as net position. Net position may be reported as:

- Restricted component of net position consists of restricted assets reduced by liabilities related to those assets. Restricted net assets result when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted component of net position consists of net amount of the assets and liabilities that do not meet the definition of the preceding category. Unrestricted component of net position often is designated in order to indicate that management does not consider them to be available for general operations. Unrestricted component of net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

As of June 30, 2019, the Revolving Fund net position is presented as restricted.

The statement of revenues, expenses, and changes in net position demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Operating expenses are those that relate to the administration of the Revolving Fund. Other items not meeting the definition of program revenues or operating expense are reported as non-operating revenues or expenses.



Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Cash and cash equivalents

Time deposits with maturities at date of purchase of three months or less are classified as cash equivalents. Cash and cash equivalents are carried at cost, which approximates fair value. As of June 30, 2019, The Revolving Fund maintains approximately \$57.6 million in cash equivalents.

Loan receivable and allowance for loan losses

Loans are presented at the outstanding principal balance reduced by allowance for loan losses. The allowance for loan losses is established through a provision recorded in the statement of revenues, expenses and changes in net position. The allowance for loan losses is based on management's evaluation of the risk characteristics of the loans including such factors as the nature of individual credit outstanding, past loss experience, known and inherent risk in the portfolios' sources of repayment, adverse situation that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. Loan charge-offs are recorded against the allowance when management believes that the collection of the principal is unlikely. Recoveries of amount previously charged off are credited to the respective allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the outstanding loans receivable portfolios and the related allowance may change if economic and other conditions differ substantially from the assumptions used in making the estimates. Such adjustment to original estimates, as necessary, are made in the period on which these factors and other relevant considerations indicate that loss levels vary from previous estimates.

The Revolving Fund considers loans as impaired based on current information and events, including significant delays in the receipt of the scheduled debt service payments. In management's opinion, it is highly probable that the Revolving Fund will be unable to collect all amounts due according to the loan's original contractual terms. To establish an allowance for loans losses, the Revolving Fund's management used applicable authoritative literature, general background information and recent relevant information included in the Commonwealth and PRASA's fiscal plan, including, as further discussed in Note 8, a forbearance agreement ("Forbearance Agreement") that PRIFA, DOH and the Puerto Rico Department of Natural and Environmental Resources ("DNER") entered into on June 30, 2016 with PRASA, whereby PRIFA, among other things, agreed to a temporary forbearance of its rights and remedies under the Revolving Fund Loan documents against PRASA. In addition, the terms and conditions of the PRASA's debt restructuring agreed to subsequent to year end, as discussed in Notes 3, 6 and 12, were employed for allowance for loan losses determination. The Revolving Fund established an allowance for losses on the impaired loans based on management's estimate of the present value of expected debt services payment discounted at the loans' effective interest rate.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Loan receivable and allowance for loan losses – (continued)

In relation to income recognition, the Revolving Fund classifies loans as nonaccrual when management determines if any of the following characteristics are present: (a) a loan was six months past due; (b) it has no current source of repayment; (c) it is not covered by formal commitment from the Puerto Rico Aqueduct and Sewer Authority; and (d) it does not have designated collateral, or such collateral is insufficient. Based on these four elements, when a loan is placed in nonaccrual status, interest receivable is reversed from interest income. Interest income on nonaccrual loan is thereafter recognized in income only to the extent that it is collected. Nonaccrual loans are returned to accrual status when management has adequate evidence to believe that the loans would perform as contracted.

Also, as the loans made and collected (including interests on loans) are part of a governmental program, the loan activities are reported as operating activities in the statement of cash flows.

Recent accounting pronouncements

The GASB has issue the following accounting pronouncements that have effective dates after June 30, 2019:

- GASB Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The requirements of this Statement were originally effective for reporting periods beginning after June 15, 2018. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.
- GASB Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement were originally effective for reporting periods beginning after December 15, 2018. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

- GASB Statement No. 87, Leases. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement were originally effective for reporting periods beginning after December 15, 2019. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by eighteen months.
  
- GASB Statement No. 88, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this Statement were originally effective for reporting periods beginning after June 15, 2018. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

- GASB Statement No. 89, Accounting for Interest Cost Incurred Before the End of a Construction Period. This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles. The requirements of this Statement were originally effective for reporting periods beginning after December 15, 2019. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.
- GASB Statement No. 90, Majority Equity Interests. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain components units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. The requirements of this Statement were originally effective for reporting periods beginning after December 15, 2018. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.
- GASB Statement No. 91, Conduit Debt Obligations. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (i) commitments extended by issuers, (ii) arrangements associated with conduit debt obligations, and (iii) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

This Statement also addresses arrangements-often characterized as leases- that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. The requirements of this Statement were originally effective for reporting periods beginning after December 15, 2020. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.

- GASB Statement No. 92, Omnibus 2020. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the following: The effective date of *Statement No. 87, Leases, and Implementation Guide No. 2019-3, Leases*, for interim financial reports; reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; the applicability of *Statements No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, as amended, and *No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for postemployment benefits; the applicability of certain requirements of *Statement No. 84, Fiduciary Activities*, to postemployment benefit arrangements; measurement of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature; and terminology used to refer to derivative instruments. The requirements of this Statement were originally effective for reporting periods beginning after June 15, 2020. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective date is postponed by one year.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

- GASB Statement No. 93, Replacement of Interbank Offered Rates (IBOR). The objective of this Statement is to address accounting and financial reporting implications that result from the replacement of an IBOR most notably the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form at the end of 2021, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates, by either changing the reference rate or adding or changing fallback provisions related to the reference rate.

The removal of LIBOR as an appropriate benchmark interest rate was originally effective for reporting periods ending after December 31, 2021. All other requirements of this Statement were originally effective for reporting periods beginning after June 15, 2020. As amended by GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*, the effective dates are postponed by one year.

- GASB Statement No. 94, Public Private and Public-Public Partnership and Availability Payment Arrangement. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). A PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). An APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction.

The requirements of this Statement are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance* does not postpone the effective date of this Statement because the pandemic of COVID – 19 was factored into the statement’s effective date.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

- GASB Statement No. 95, Postponement of the effective dates of Certain Authoritative Guidance. The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

The effective dates of certain provisions contained in the following pronouncements are postponed by one year:

- *Statement No. 83, Certain Asset Retirement Obligations*
- *Statement No. 84, Fiduciary Activities*
- *Statement No. 88, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- *Statement No. 89, Accounting for Interest Cost Incurred before the End of a Construction Period*
- *Statement No. 90, Majority Equity Interests*
- *Statement No. 91, Conduit Debt Obligations*
- *Statement No. 92, Omnibus 2020*
- *Statement No. 93, Replacement of Interbank Offered Rates*
- *Implementation Guide No. 2017-3, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*
- *Implementation Guide No. 2018-1, Implementation Guidance Update—2018*
- *Implementation Guide No. 2019-1, Implementation Guidance Update—2019*
- *Implementation Guide No. 2019-2, Fiduciary Activities.*

The effective dates of the following pronouncements are postponed by 18 months:

- *Statement No. 87, Leases*
- *Implementation Guide No. 2019-3, Leases.*

Earlier application of the provisions addressed in this Statement is encouraged and is permitted to the extent specified in each pronouncement as originally issued.

The requirements of this Statement are effective immediately.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

- GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended.

The requirements of this Statement are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged.

- GASB Statement No. 97, *Certain Component Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans- An Amendment of GASB Statements No. 14 and No. 84, and a Supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

The requirements of this Statement that (1) exempt primary governments that perform the duties that a governing board typically performs from treating the absence of a governing board the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans and (2) limit the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, respectively, are effective immediately.



Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 2 - Summary of significant accounting policies – (continued)

Recent accounting pronouncements – (continued)

The requirements of this Statement that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021. For purposes of determining whether a primary government is financially accountable for a potential component unit, the requirements of this Statement that provide that for all other arrangements, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform, are effective for reporting periods beginning after June 15, 2021. Earlier application of those requirements is encouraged and permitted by requirement as specified within this Statement.

The Board considered the effective dates for the requirements of this Statement in light of the COVID-19 pandemic and in concert with *Statement No. 95, Postponement of the Effective Dates of Certain Authoritative Guidance*.

Management is evaluating the impact that these Statements will have, if any, on the Revolving Fund's basic financial statements.

Note 3 - Uncertainty and liquidity risk

As further discussed in Note 6, PRASA has not been able to meet in full its scheduled debt service payments on the loans granted by the Revolving Fund. Therefore, management of the Revolving Fund determined that an allowance for such loans was required, which amounted to approximately \$38.7 million as of June 30, 2019.

This loss event, together with past credit losses in the Revolving Fund's deposits with GDB, have brought a significant reduction in the Revolving Fund's net position and liquidity, as well as temporarily halting the disbursement of funds for the construction of drinking water infrastructure to PRASA, to the point of raising substantial doubt about its ability to continue serving the purposes of the safe drinking water treatment revolving loan program, especially as the Revolving Fund had been partially inactive since then.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 3 - Uncertainty and liquidity risk – (continued)

Remediation Plan

As further described in Note 12, in response to the approved fiscal plan provisions of the Commonwealth, as well as the approved General Fund Budget for fiscal year 2019, the Commonwealth recapitalized the Revolving Fund and the Puerto Rico Water Pollution Control Revolving Fund (together known as the State Revolving Funds or SRFs), by making a \$194.5 million contribution (\$141.2 million and \$53.3 million on behalf of the Puerto Rico Water Pollution Control Revolving Fund and the Revolving Fund, respectively) to such funds during December 2018, deposited in separate Trust accounts of new creation, from which both revolving funds would now be able to resume or reactivate the operations for which they were created. This recapitalization has also allowed the EPA to authorize disbursements and loans to PRASA in regard to the Revolving Fund.

With respect to the collectability of the Revolving Fund's loans, the Commonwealth reached an agreement with the Environmental Protection Agency (EPA) on July 26, 2019 to restructure approximately \$596 million in debt with the SRF's. The agreements modify the economic terms of approximately \$596 million in outstanding SRF loans, approximately \$192.5 million pertaining to the Revolving Fund, eliminate the Commonwealth's guaranty of such debt, and designate such debt as parity senior debt with PRASA's other senior debt pursuant to the terms of PRASA's existing Master Agreement of Trust. The agreement was approved by the Oversight Board, ending the need for continued forbearance agreements related to the federal debt and removing uncertainties about PRASA's future. Refer to Note 12 to the basic financial statements for further information.

Future capitalization grants are dependent on the availability of funds from the Commonwealth to match a required percentage under Federal Law; which in turn depends on budgetary appropriations made by the Legislature and the certification of such allocations by the Oversight Board, which actions are beyond the control of the Revolving Fund (see Notes 4 and 12). Notwithstanding, the aforementioned remediating activities already in effect alleviate the substantial doubt about the Revolving Fund's ability to continue serving the purposes of the safe drinking water treatment revolving loan program.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 4 - Custodial credit risk

Custodial credit risk is the risk that in the event of a bank failure of a depository financial institution, the entity will not be able to recover its deposits. The Revolving Fund does not have a custodial credit policy.

On March 23, 2018, GDB ceased its operations, and it has been since then winding down in an orderly fashion under Title VI of Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). As GDB served in prior years as the depository of most of the Revolving Fund's funds, the Revolving Fund's cash, time deposits and accrued interest receivable on deposits, based on an evaluation of the availability and recoverability of such deposits, a custodial credit loss on deposits and related accrued interest at GDB was recorded in an aggregate amount of \$47.6 million on the Revolving Fund's financial statements in prior years.

Pursuant Title VI of PROMESA, GDB restructured its obligations on November 29, 2018. Such restructuring requires the offset between financial instruments assets and liabilities held by GDB. Since the SDWRF does not have loans with GDB, funds custodial credit loss recognized in prior years was formalized. Thus, during the fiscal year ended on June 30, 2019, the Revolving Fund recognized the write off on deposits with GDB amounting to approximately \$47.6 million.

Transfer of funds from the Commonwealth

The Commonwealth, with the approval of the Oversight Board, included in its budget for fiscal year 2019, \$53.3 million to be transferred to the Revolving Fund in restitution of the deposits lost because of GDB's insufficient liquidity. As mentioned above, the Revolving Fund had approximately \$47.6 million deposited in the GDB and frozen during fiscal year 2016.

The EPA requested the transfer of said funds in a lump sum as soon as appropriate since these funds would go a long way in helping to stabilize the SRFs and enable them to provide significant financial assistance to Puerto Rico communities to address critical water and wastewater infrastructure problems for the maximum benefit to the people. On November 21, 2018, the Oversight Board agreed and authorized the disbursement and in December 2018, the Revolving Fund received \$53.3 million from the Commonwealth of Puerto Rico.

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Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 4 - Custodial credit risk – (continued)

Cash and cash equivalents as of June 30, 2019 were deposited as follows:

Deposits held at June 30, 2019

Type of Deposit	Amount
Cash and escrow deposit at commercial bank	\$ 2,399,678
Time deposits at commercial bank	57,599,643
	\$ 59,999,321

The Commonwealth requires that public funds deposited in a commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance.

Note 5 - Transactions with Puerto Rico Fiscal Agency and Advisory Authority

Since the Puerto Rico Fiscal Agency and Advisory Authority (AAFAF) had certain responsibilities with the Revolving Fund, AAFAF provided certain management services to the Revolving Fund at no cost during the year ended June 30, 2019.

Note 6 - Loans receivable from Puerto Rico Aqueduct and Sewer Authority (PRASA)

At June 30, 2019, loans, all to PRASA, consist of the outstanding balances as following:

Type of loan	Loans at June 30, 2019		
	Loans Balance	Allowance for Loans Losses	Loans Balance, net
Permanent loan (PRASA)	\$ 135,966,424	\$ (28,460,519)	\$ 107,505,905
Construction loan	49,003,783	(10,257,481)	38,746,302
Total	\$ 184,970,207	\$ (38,718,000)	\$ 146,252,207

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Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 6 - Loans receivable from Puerto Rico Aqueduct and Sewer Authority (PRASA) – (continued)

The reconciliation to the statement of net position as of June 30, 2019 is as follows:

	Amount
Current portion, net	\$ 277,778
Noncurrent portion, net	145,974,429
Total loans receivable, net	\$ 146,252,207

Permanent loans are due in semiannual installments bearing interest at 2% per annum, maturing on various dates through January 1, 2033. Permanent loans receivable as of June 30, 2019, mature as follows:

Years Ending June 30,	Amount
2020	\$ 32,599,436
2021	9,150,431
2022	9,334,355
2023	9,521,976
2024	9,477,078
Thereafter	65,883,148
	135,966,424
Less: allowance for loan losses	(28,460,519)
Permanent loans (PRASA), net	\$ 107,505,905

Future payments for the fiscal year ended on June 30, 2020 included scheduled debt service payments overdue from previous years.

Construction loans bear interest at various rates ranging from 1.5% to 2% per annum and principal will be payable semiannually commencing no later than eighteen (18) months after construction completion date. All loans are required to be paid in full in a period not to exceed 30 years or up to 40 years for state-defined disadvantaged communities, or design life, whichever is shorter. For construction loans, such period commences after the construction loan is converted to a permanent loan. Interest on construction loans are payable semiannually since inception of the loan.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 6 - Loans receivable from Puerto Rico Aqueduct and Sewer Authority (PRASA) – (continued)

The Revolving Fund is operated as a direct loan program, whereby most of the loans made to PRASA are funded by capitalization grants from the EPA and a Commonwealth match equaling 20% of the EPA's capitalization grant. All of the outstanding loans are funded with EPA capitalization grants, state match funds, and with funds from the results of the operations of the SDWRF.

Pursuant to Act 96 of June 30, 2015 (the Act 96), the Commonwealth guarantees the payment of principal and interest on most of the outstanding Revolving Fund loans granted to PRASA on or before June 30, 2020. Loans covered by Act 96 include a statement of such guarantee in the loan agreement.

Notwithstanding that a guaranty from the Commonwealth exists, the current financial situation of the Commonwealth is precarious and the possibility that available resources will be insufficient to cover the guaranty in its entirety prevails. PRASA is also experiencing a challenging financial scenario, with its ability to fulfill all of its financial commitments currently impaired, including those obligations incurred under the Revolving Fund loans. As a result, PRASA has been seeking relief through the modification of its debt obligations.

The Commonwealth's guaranty related to all the original financing agreements, and the bonds and loans issued was terminated on July 26, 2019, and the new loans are not subject to the guaranty and the obligations of PRASA under the new loan agreements and the notes will not constitute Commonwealth guaranteed indebtedness under the trust agreement. Any future right to the Commonwealth guaranty was waived.

Loans are considered impaired based on current information and events, including a letter to the Electronic Municipal Market Access System (EMMA) dated March 16, 2016 and the eventual significant delays in the receipt of the scheduled debt service payments.

The letter to EMMA disclosed the situation that caused a backlog of unpaid obligations to contractors on PRASA's capital improvement program (CIP). In summary, as a result of the recent obstacles faced by PRASA in gaining access to the bond market for the issuance of its revenue bonds to cover the cost of its CIP, it has been unable to pay certain outstanding contractor receivables and had to suspend its ongoing CIP projects. The action plan proposed in such letter to face the situation included the following: (1) rate increases (currently in implementation stage), (2) set aside certain funds within the master agreement trust in order to make payments to its contractors, which did not include any payment to the Revolving Fund, (3) the approval by the Senate of Puerto Rico of the legislation to create a special purpose entity for a bond issuance (the creation of such entity never materialized), (4) PRASA had a \$180 million credit line from GDB (no longer available due to the wind down and restructuring of GDB in November 2018) and (5) obtaining financing from a willing investor, with or without the approval of legislation.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 6 - Loans receivable from Puerto Rico Aqueduct and Sewer Authority (PRASA) – (continued)

Considering that the action plan has had no significant development and that beginning on June 30 2016, a series of debt forbearance agreements were entered with PRASA (see Note 8), the Revolving Fund established an allowance for loan losses on identified impaired loans based on management's estimate of the present value of expected debt service payments discounted at the loans' effective interest rate.

The PRASA's debt restructuring agreements (Both SRF and Rural Development), referred to in Notes 2, 3 and 12, were executed on July 26, 2019 and publicly disclosed through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access, on August 9, 2019, in accordance with the Securities and Exchange Commission timelines. As a result of this restructuring, during the year ended on June 30, 2019, management was able to release allowance for loan losses amounting to \$3,507,000, that was provided in prior year, and which is included as release of provision for loan losses in the accompanying statement of revenues, expenses and changes in net position for the year then ended.

Note 7 - Capitalization grants

The Safe Drinking Water Act (the SDWA), as amended, is the main federal law that ensures the quality of the United States' drinking water. Under the SDWA, the EPA sets standards for drinking water quality and oversees different localities, and water suppliers who implement those standards. The SDWA created the federal Drinking Water State Revolving Fund to make funds available to public water systems to finance infrastructure construction and improvements needed to comply with the SDWA water quality requirements. The SDWA authorizes the EPA to award capitalization grants to states which, in turn, provide low interest loans and other types of financial assistance to eligible systems.

These grants are routinely subject to financial and compliance audits in accordance with the provisions of the *Title 2, U.S. Code of Federal Regulation Part 200, Uniform Administration Requirements, Cost Principles and Audit Requirements for Federal Award* (Uniform Guidance) and compliance audits by the EPA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance. All funds drawn from the EPA and the matching funds from the Commonwealth are recorded as non-operating revenues. As of June 30, 2019, the EPA has awarded capitalization grants of \$237,297,000 to the Revolving Fund of which \$195,964,537 have been drawn for loans, administrative expenses and technical assistance expenses.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 7 - Capitalization grants – (continued)

The following summarizes the capitalization grants awarded, amounts drawn on each grant as of the statement of net position date, and balances available for future draws:

June 30,	Grant amount	Total draws at June 30, 2018	Draws during 2019	Total draws at June 30, 2019	Available at June 30, 2019
1998	\$ 22,783,800	\$ 22,783,800	\$ -	\$ 22,783,800	\$ -
1999	10,716,700	10,716,700	-	10,716,700	-
2000	11,137,800	11,137,800	-	11,137,800	-
2001	11,183,800	11,183,800	-	11,183,800	-
2002	10,741,300	10,741,300	-	10,741,300	-
2003	10,676,700	10,676,700	-	10,676,700	-
2004	11,075,500	11,075,500	-	11,075,500	-
2005	11,052,100	11,052,100	-	11,052,100	-
2006	8,229,300	8,229,300	-	8,229,300	-
2007	8,229,000	8,229,000	-	8,229,000	-
2008	8,146,000	8,146,000	-	8,146,000	-
ARRA	19,500,000	19,500,000	-	19,500,000	-
2009	8,146,000	8,146,000	-	8,146,000	-
2010	13,573,000	13,573,000	-	13,573,000	-
2011	9,418,000	9,418,000	-	9,418,000	-
2012	8,975,000	8,533,313	-	8,533,313	441,687
2013	8,421,000	6,330,571	61,268	6,391,839	2,029,161
2014	8,845,000	5,960,036	470,349	6,430,385	2,414,615
2015	8,787,000	-	-	-	8,787,000
2016	8,312,000	-	-	-	8,312,000
2017	8,241,000	-	-	-	8,241,000
2018	11,107,000	-	-	-	11,107,000
	<u>\$ 237,297,000</u>	<u>\$ 195,432,920</u>	<u>\$ 531,617</u>	<u>\$ 195,964,537</u>	<u>\$ 41,332,463</u>

At June 30, 2019, the Revolving Fund had \$11,107,000, \$8,241,000, \$8,312,000 and \$8,787,000 from the grants awarded by the EPA for the federal fiscal years ended September 30, 2018, 2017, 2016 and 2015, respectively, that are available to be drawn for loan commitments once all the EPA requirements have been met. As of June 30, 2019, PRIFA, PRASA and other parties have not executed financial agreements related to these awards. The grants awarded by the EPA are available to be drawn for administrative and technical assistance expenses.



Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 8 - Revolving funds loan forbearance

On June 30, 2016, in light of PRASA's liquidity constraints, PRIFA, DOH, and the Puerto Rico Department of Natural and Environmental Resources (DNER) entered into a forbearance agreement with PRASA (the Forbearance Agreement), under which PRIFA, among other things, agreed to a temporary forbearance of its rights and remedies under the Revolving Fund Loan documents against PRASA and under the Commonwealth Guaranty through December 30, 2016. The Forbearance Agreement was reached in order to facilitate a reasonable due diligence and negotiation period necessary to achieve definitive agreements for the restructuring of PRASA's obligations related to such Revolving Fund Loan facilities.

At different dates between December 14, 2016 through July 26, 2019, PRIFA, DNER, DOH and PRASA have entered into nine additional amendment agreements, the last one expired on July 31, 2019, to amend certain provisions of the forbearance and to provide for an additional temporary forbearance of potential defaults and events of default that may arise under the Forbearance Agreement and the Revolving Loan documents.

On July 26, 2019, the forbearance agreements were terminated and escrowed funds applied to the SRF loans as part of the PRASA's debt restructuring agreement, described in Notes 3, 6 and 12.

Note 9 - Notice of noncompliance

Following meetings with the directors or representatives of PRIFA, the DOH and GDB between September 12 and 15 of 2016, the EPA, concerned with the continuing delays in processing payments for drinking water treatment projects funded by the Revolving Fund, issued on October 3, 2016 to these agencies, a Notice of Noncompliance with their obligations and federal requirements for the management of the Revolving Fund.

Based on information received by PRIFA, DOH and GDB, the EPA determined that these agencies, with particular reference to GDB, did not comply with the federal requirements to (1) establish, maintain, invest and credit the Revolving Fund with repayments, such that the fund balance will be available in perpetuity for authorized and eligible water pollution control activities, (2) maintain the Revolving Fund in a manner that ensures the funds are used for authorized purposes and (3) maintain a separate account or series of accounts for the Revolving Fund that are dedicated solely to providing loans and financial assistance for the purpose authorized by the Safe Drinking Water Act.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 9 - Notice of noncompliance – (continued)

The Notice of Noncompliance identified steps that the aforementioned agencies had to take to be in full compliance with the requirements of the Safe Drinking Water Act and remain eligible for federal drinking water funding. The Notice of Noncompliance also required the submittal of a corrective action plan to the EPA. The Notice of Noncompliance was referred to the EPA's Office of Inspector General (OIG).

The recapitalization discussed in Note 4 has also allowed the EPA to authorize disbursements and loans to PRASA in regard to the Revolving Fund. Also, the finalization of the restructuring agreement discussed in Note 12 will ensure the repayment of PRASA's SRF loans and PRASA will be eligible to apply for financial assistance from the SRF funds, which helps ensure the continued protection of public health and the environment for the residents of Puerto Rico.

Note 10 - Financial management audit by EPA's OIG

On September 16, 2016, the EPA's OIG received a hotline complaint from the EPA identifying financial irregularities with the SRFs. The complaint reported of a combined balance of approximately \$194.5 million for the SRFs (\$53.3 million for the Revolving Fund) at GDB but that GDB did not have the assets to honor such balances. Pursuant the receipt of the hotline complaint, the OIG conducted an audit to accomplish the following objectives:

- Identify the source of the funds that made up the \$194.5 million in question.
- Determine the current status of the \$194.5 million and the potential for recovery.
- Identify the causes for the alleged financial irregularities.
- Determine when the agencies responsible for administering the SRFs knew or should have known about the financial crisis and GDB's failure, and determine what actions or measures, if any, these agencies could have taken to secure the funds in question.
- Determine if the EPA performed adequate oversight.

The audit was conducted from October 31, 2016 to February 15, 2017, in accordance with generally accepted auditing standards issued by the Comptroller General of the U.S.

The OIG audit confirmed that the \$194.5 million in question (\$53.3 million for the Revolving Fund) were not available because GDB did not have the assets to honor the balance, as a result of the severe and ongoing financial crisis faced by the Commonwealth and GDB. However, although the EPA and the SRFs managing agencies (PRIFA, the DNER and DOH) were all aware of the financial crisis of Puerto Rico, they had no reason to believe and received no early indications prior to March 31, 2016 that the SRFs funds at GDB would ultimately be impaired. The OIG audit report went further by stating that the EPA could not have predicted or prevented this situation.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 10 - Financial management audit by EPA's OIG – (continued)

The audit also revealed that there were no indications that the SRFs managing agencies commingled or misused the funds held with GDB and as soon as the irregularities were discovered. The EPA provided adequate oversight to address the issues and worked with the managing agencies to safeguard the future revolving fund transactions. The Commonwealth recognized its obligation and has included restoration of the SRFs funds in its 10-year fiscal plan for fiscal year 2019 (see related disclosure of this restoration further below); nonetheless, withdrawals of any significance in the near future were determined to be highly unlikely.

The OIG audit also determined that approximately \$580 million in repayments to the SRFs owed by PRASA were at risk; however, that there was no indication that such repayments were at risk until February 26, 2016.

As discussed in Note 4, the Commonwealth transferred \$194.5 million to the SRFs (\$53.3 million for the Revolving Fund) in restitution of the deposits lost because of GDB's insufficient liquidity.

Note 11 - Administrative expenses

As provided by federal laws and regulations, reasonable costs of administering the Revolving Fund are reimbursable under federal programs up to a maximum of 4% of the capitalization grant awarded each year. The federal government also reimburses expenses incurred in training and certifying personnel as well as technical matters and other set-asides, as determined by the Department of Health. During the year ended June 30, 2019, total reimbursement of administrative expenses amounted to \$526,679.

Note 12 - Subsequent events

Subsequent events were evaluated through September 13, 2021, the date the basic financial statements were available to be issued. Management believes that the subsequent events disclosed below are intrinsically related to the financial statements of the Revolving Fund. These might have been disclosed elsewhere in these financial statements, but management believes they require specific mentioning based on their relevance and materiality as a whole.

Amendments to the Trust Agreement

On July 26, 2019, PRASA and Banco Popular of Puerto Rico (the Trustee) entered into a seventh supplemental Agreement of trust, dated as of July 26, 2019, in order to clarify and amend certain provisions in the trust agreement, including, among other things, that the loans provided by the SRF to PRASA are not Commonwealth guaranteed indebtedness (as defined in the trust agreement).

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 12 - Subsequent events – (continued)

Fiscal plans for the Commonwealth and PRASA

The Commonwealth fiscal plan

On April 23, 2021, the Oversight Board approved and certified its own fiscal plan for the Commonwealth (the “Commonwealth Fiscal Plan”). The Commonwealth Fiscal plan commits to fiscal responsibility and implements specific revenue enhancements and targeted expenditure reductions to return the Commonwealth to fiscal stability and economic growth. Detailed information about the Commonwealth Fiscal Plan is disclosed in the portal page of the Oversight Board.

The PRASA fiscal plan

On May 27, 2021, the Oversight Board approved and certified a 5-year fiscal plan for PRASA (the “PRASA Fiscal Plan”). The PRASA Fiscal Plan includes a series of new initiatives, including, among others, rate increases, new federal funds, pension reform, electricity expense reduction, Christmas bonus elimination, health care savings, reductions in physical water losses, organizational optimization, chemical expense reduction, among others. Detailed information about the PRASA Fiscal Plan is disclosed in the portal page of the Oversight Board.

PRASA’s debt restructuring

On July 26, 2019, the U.S. Environmental Protection Agency (EPA) and Puerto Rico Aqueduct and Sewer Authority (PRASA) restructured certain delinquent loans – amounting to approximately \$596 million in principal – owed to Puerto Rico’s Water Pollution Control (WP) and Drinking Water (DW) State Revolving Fund (SRF) programs. PRASA entered into the loan agreements in order to restructure certain existing loans from the SRF funds and the notes issued by PRASA under the new loan agreements superseded and replaced all outstanding obligations with the SRF funds. The SRF also waived all accrued and unpaid interest with respect to the old debt. The new loan agreements each have a term of thirty years commencing on January 1, 2020 (effective date) and bear interest at 0.0% for the first 10 years and 1% for the next 20 years. The loans and notes issued by PRASA to the applicable SRF were incurred by PRASA as other system indebtedness and have been designated as senior indebtedness under the master agreement of trust, between PRASA and Banco Popular de Puerto Rico, as trustee, and as amended by the seventh supplemental agreement of trust. The new loans provided by the SRF to PRASA are not Commonwealth guaranteed indebtedness, as defined in the trust agreement and the Commonwealth guaranty related to all the original financing agreements was terminated.

Puerto Rico Safe Drinking Water Treatment  
Revolving Loan Fund

Notes to Basic Financial Statements – (continued)

June 30, 2019

Note 12 - Subsequent events – (continued)

Fiscal plans for the Commonwealth and PRASA – (continued)

PRASA's debt restructuring – (continued)

On December 17, 2020, PRASA issued 2020 Series A and Series B Revenue Refunding Bonds amounting to \$1,351.3 million and \$18.8 million respectively. The proceeds of the 2020 Senior Bonds were used to (i) refinance a portion of the currently outstanding 2008 Revenue Bonds Series A and Series B (Senior Lien) issued under the Trust Agreement, excluding the non-callable convertible capital appreciation bonds, (ii) refinance all PRASA's Revenue Refunding Bonds 2008 Series A and Series B each guaranteed by the Commonwealth and (iii) pay cost of issuance of the 2020 Senior Bonds. The 2020 Bonds bear coupons at rates ranging from 4% to 5% per annum with yields at the time of issuance ranging from 2.50% to 4.50% with maturity rates ranging from July 1, 2021 to July 1, 2047. The proceeds of the 2020 Bonds amounting to \$1,471.1 million, including \$101 million in premium, were used to pay (i) \$10.4 million in underwriters discount and other cost of issuance and (ii) deposit \$1,460.7 million in an irrevocable trust with an escrow agent to pay outstanding principal and accrued interest for the refunded bonds on the applicable redemption date. As a result, the refunded bonds are considered defeased. The defeasance of the refunded bonds resulted in a reduction in PRASA's total debt service payments over the next 27 years of approximately \$348.2 million and resulted in an economic gain of approximately \$213.3 million.

On July 20, 2021, the Fiscal Oversight and Management Board for Puerto Rico approved a Financial Assistance Agreement with PRASA amounting to \$46.3 million which is composed of \$22.2 million as a senior interest bearing (1%) loan with a 30-year amortization term and the remaining \$24.1 million as non-interest bearing and principal forgiveness loan. The proceeds of this financial assistance agreement will finance various water treatment plants and water intake projects.

Capitalization agreements

On May 19, 2020 and September 21, 2020, the Revolving Fund received capitalization grant award notifications for the fiscal years 2019 and 2020, respectively, amounting to \$11,004,000 and \$11,011,000, respectively.