PUBLIC UTILITIES CORPORATION
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2007 AND 2006

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Public Utilities Corporation:

We have audited the accompanying statements of net assets of the Public Utilities Corporation (PUC), a component unit of the Republic of Palau, as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of PUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of PUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of PUC as of September 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As disclosed in note 3 to the financial statements, at September 30, 2007 and 2006, PUC had $2,058,378 and $2,004,055, respectively, of uninsured and uncollateralized deposits with a bank that went into receivership on November 7, 2006. PUC wrote down the receivable and recorded an allowance of $1 million against the deposits at September 30, 2007. We are unable to assess the recoverability of the remaining balance of the deposits.

The Management's Discussion and Analysis on pages 3 through 12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of PUC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 15, 2008 on our consideration of the PUC'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* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

July 15, 2008

This Management's Discussion and Analysis (MD&A) presents the Public Utilities Corporation's (PUC) financial performance during the fiscal year ended September 30, 2007. Please read it in conjunction with the audited financial statements as of and for the year ended September 30, 2007, which follow this section.

In preparing this MD&A, forward-looking statements about operational and/or financial matters may be used. Such statements are usually identified by words such as "expected", "could", etc. Matters discussed in these statements are subject to risks and changes. The reader should not assume such statements are guarantees.

FINANCIAL HIGHLIGHTS

PUC, with some effort, maneuvered its way out of the operational and financial quagmire of FY2006. After the engine crisis of FY2006, management began FY2007 with a focus on restoring reliable power. The two damaged base-load generators were successfully repaired and placed back in service in December 2006, providing the needed power capacity. Management then commenced strategic studies the goal of which was to achieve operational self-reliance. Additionally, negotiations were initiated for a five megawatt (MW) base-load generator with significant progress achieved at year end. A new generator will not only alleviate power unreliability but also provide some savings with higher fuel efficiency than the existing generators. It is planned that the generator will retire two of PUC's aged generators. Currently, a seventeen-year master plan is being developed which will provide PUC a needed roadmap towards self-sustainability and responsiveness to economic development challenges.

Overall, some positive impact was realized on our net operating results, with operating losses reduced from $4.7 million in FY2006 to only $2.8 million in FY2007. Highlights are as follows:

- PUC's total assets of $49.4 million as of FY2007 increased by $0.9 million from FY2006.
- PUC's net utility plant, stated at $27.6 million as of FY2007, decreased from FY2006 by $1.1 million.
- At the end of FY2007, PUC reported net assets at $38.9 million, of which $12.0 million, or 31%, represented unrestricted net assets. Net reduction to net assets for FY2007's net loss was $2.8 million, an improvement from FY2006's $4.0 million.
- During FY2007, operating revenues aggregated to $19.7 million, an increase of 11% from FY2006. This is attributed to rate increases triggered by the rise in diesel fuel prices.
- During FY2007, operating expenses topped $22.5 million exceeding FY2006's $22.4 million (a 1% increase). The increase was driven by the rising diesel fuel price which peaked at $2.55/gallon at the end of FY2007. Fuel cost alone in FY2007 at $16 million comprised a whopping 72% of total operating expenses compared to 69% in FY2006. Other operating expenses showed little change or actual reduction to accommodate the increased fuel price.
- Net investment earnings for FY2007 surpassed expectations at $1.2 million, a significant increase over last year's $0.5 million earnings.
- Another significant contributor to total net loss at year end was a writedown of a deposit with a failed local bank in the amount of $1 million.

REQUIRED FINANCIAL STATEMENTS

PUC's basic financial statements aim to present the financial condition of the Company and the results of its operations on a fiscal year basis. These are comprised of the following:

The ***Statement of Net Assets*** presents all PUC assets, liabilities, and net assets (difference between assets and liabilities). This provides information about the nature of investments in resources (assets) and obligations of PUC to creditors (liabilities). It also provides the bases for assessing liquidity, leverage, and financial flexibility of PUC. Because of the critical role of plant assets to PUC's operations, plant assets are presented first showing original costs, accumulated depreciation, and net value. For the same reason, net assets is presented first under the *Liabilities and Net Assets* section. Net assets is subdivided into net assets invested in plant assets, restricted net assets and unrestricted net assets.

All of current year's revenues and expenses are accounted for in the ***Statement of Revenues, Expenses and Changes in Net Assets***. This statement measures the net results of operations (income or loss) during the current fiscal year by presenting major sources of income (operating revenues), major expenses (operating expenses), and nonoperating incidental revenues and expenses. External contributions towards plant expansions, if any, are presented after nonoperating revenues (expenses) as *capital contributions*. The statement is useful for reviewing PUC's financial performance compared to the prior year, and helps to determine PUC's credit worthiness.

Finally, the ***Statement of Cash Flows*** provides information about cash activities during the reporting period. This statement reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from operations, investing activities, and non-capital and capital and related financing activities. Cash and cash equivalents are defined as cash on hand, cash in checking and savings accounts, and time certificates of deposits maturing within three months of issuance.

Notes to the Financial Statements are an integral part of the PUC financial statements. They provide essential information necessary for a fuller understanding of the accounts presented in the basic financial statements. The notes elaborate on off-balance sheet credit risks, commitments, and contingencies not evident on the face of the basic financial statements, as well as identify significant events occurring beyond the scope of the financial statements but which have potential material impact on the reported year's financial picture.

FINANCIAL ANALYSIS OF PUC AS A WHOLE

The following analysis focuses on PUC's net assets (Table 1) and changes in net assets (Table 2) during the year. Our analysis aims to determine whether PUC's financial condition improved or deteriorated as a result of this year's operations, and the underlying reasons for such changes.

Table 1

NET ASSETS

(Dollars in Thousands)

	Sept 30, 2007	Sept 30, 2006	Sept 30, 2005	Inc (Dec) 2007 to 2006	Inc (Dec) 2006 to 2005
Current assets	$ 15,253	$ 17,598	$ 19,516	$ (2,345)	$ (1,918)
Other assets	6,587	2,270	-	4,317	2,270
Net utility plant	27,598	28,652	30,608	(1,054)	(1,956)
Total Assets	49,438	48,520	50,124	918	(1,604)
Current liabilities	3,540	6,780	4,371	(3,240)	2,409
Other liabilities	7,016	16	16	7,000	-
Total Liabilities	10,556	6,796	4,387	3,760	2,409

Invested in capital assets	26,918	28,652	30,608	(1,734)	(1,956)
Unrestricted	11,964	13,072	15,129	(1,108)	(2,057)
Total Net Assets	$ 38,882	$ 41,724	$ 45,737	$ (2,842)	$ (4,013)

Increase in other assets in FY2007 compared to FY2006 is related to the increase in other liabilities. PUC received a $7 million loan in December 2006, the purpose of which was to repair damaged generators, acquire two mobile generators, and purchase a new 5MW generator. Approximately $2 million of the loan proceeds have been expended in line with the loan purpose. The remaining proceeds were invested until such time construction of the new generator commences. FY2006's decrease in current assets is attributed to reclassification of approximately $2 million of time certificates of deposits held by a local bank to "Other Assets" when the bank was placed in receivership. This was written down by $1 million to estimated realizable value in FY2007.

Decline in plant assets is primarily the result of depreciation. Table 4 below (*Capital Assets and Depreciation*) provides a more detailed analysis of plant assets.

During FY2006, short-term loans were acquired to finance working capital shortfalls. The outstanding aggregate balance at end of FY2006 was stated at $4.5 million, an increase of $2.8 million from FY2005. Of this, $2.2 million was collateralized by time certificates of deposits and $2.3 million was collateralized by investments. These loans were retired during FY2007 by offset against their respective collaterals. The only remaining short-term loan at FY2007 was $182K, collateralized by a time certificate of deposit.

Changes in PUC's net assets serve as indicators of its financial health. To fully evaluate PUC's financial health, consideration should be made of other non-financial factors such as changes in economic conditions, management long-term strategy, community demographics, and legislative mandates. Details of changes to PUC's net assets are discussed in our review of the following condensed schedule *Changes in Net Assets* (Table 2).

Table 2

CHANGES IN NET ASSETS

(Dollars in Thousands)

	FY2007	FY2006	FY2005	Change 2007 to 2006	Change 2006 to 2005
Operating revenues:					
Electric	$ 19,709	$ 17,483	$ 15,074	$ 2,226	$ 2,409
Others	308	321	415	(13)	(94)
Recovery from (provision for) bad debt	(296)	(86)	289	(210)	(375)
Total Revenue	19,721	17,718	15,778	2,003	1,940
Operating Expenses:					
Generation - fuel	16,182	15,530	12,657	652	2,873
Depreciation	2,471	2,507	2,357	(36)	150
Generation - other costs	2,029	2,355	2,445	(326)	(90)
Administration	940	1,059	1,166	(119)	(107)
Distribution and transmission	787	787	838	-	(51)
Engineering services	118	166	190	(48)	(24)
Total operating expenses	22,527	22,404	19,653	123	2,751

Nonoperating revenues (expenses), net	(36)	673	1,277	(709)	(604)
Change in net assets	(2,842)	(4,013)	(2,598)	1,171	(1,415)
Beginning net assets	41,724	45,737	48,335	(4,013)	(2,598)
Ending net assets	$ 38,882	$ 41,724	$ 45,737	$ (2,842)	$ (4,013)

REVENUES

Operating revenues-electric is comprised of kilowatt-hour (kWh) sales and monthly fixed charges. Monthly fixed charges are designed to recover PUC's monthly fixed costs of providing service to customers irregardless of load demand or energy consumption. Operating revenues-others comprises of miscellaneous sales, installation fees, and late charges. Operating revenues showed positive gains in all three fiscal years with a 29%, 12% and 11% increase in FY2005, FY2006 and FY2007, respectively. Increases were due primarily to factored increases in fuel rates. Customer growth has tabled off and is not a significant factor in revenue performance, increasing by only 3%, 6% and 1% in FY2005, FY2006 and FY2007, respectively. This decelerated growth is likely influenced by the rising fuel price.

Nonoperating revenue-investments outperformed expectations with a 13% growth in FY2007 while FY2006 lagged at 7% and FY2005 at 9%. The $1.2 million earnings of FY2007 were practically wiped out by a $1.1 million writedown of receivables from a defunct local bank and a contractor as mentioned above. PUC received some small federal grants in FY2007 of $145K; there were none in FY2006, while FY2005 realized $393K. Interest expense increased to $260K in FY2007 with the acquisition of the $7 million loan, compared to $124K in FY2006. FY2005 interest expense was only $22K, which corresponds to the minimal borrowings in that year. In FY2005, PUC also realized a recovery of bad debt in the amount of $291K.

EXPENDITURES

The significant contributor to operating expenses in FY2007 was fuel representing 72% of total operating costs. This is a 3% increase over FY2006's percentage and an 8% increase over FY2005. These increases correspond relatively with fuel price increases over the years. The extreme spikes in fuel price rendered PUC's fuel cost recovery mechanism inadequate to fully recover its costs. This resulted in net losses of $2.8 million, $4.0 million and $2.6 million in FY2007, FY2006 and FY2005, respectively. Recognizing the limitation of the current fuel cost recovery method, PUC contracted a rate consultant in FY2007 to devise an effective mechanism for recovery of fuel cost in a timely manner.

Other operating costs remained consistent over the years except for "generation - other costs," which decreased by 14% in FY2007 due to cash constraints.

FY2007 administration cost decrease of approximately $119K is attributed to a change in PUC's insurance plan. The FY2006 administrative cost reduction from the prior year is directly related to reduced travel with the loss of two top management positions. These positions were not filled until late in the year.

Prior year's decreases in Transmission & Distribution and Engineering & Control division expenses are ascribed directly to reduced services in tandem with the decelerated customer growth rate.

For three consecutive years, PUC has suffered significant net losses of $2.8 million, $4.0 million, and $2.6 million, respectively, which have reduced net assets down to $39.0 million at the end of FY2007. Management is proactively exploring plans to strengthen operations and ensure reliability of services. With the adoption of a new tariff regulation and eventual implementation of an in-progress master plan study, management is optimistic about PUC's viability and delivery of services.

Table 3
CASH FLOWS
(Dollars in Thousands)

	FY2007	FY2006	FY2005	Change 2007 to 2006	Change 2006 to 2005
Cash flows from operating activities	$ 156	$ (3,589)	$ (2,245)	$ 3,745	$ (1,344)
Cash flows from investing activities	(1,695)	1,957	(524)	(3,652)	2,481
Cash flows from non-capital financing activities	(4,420)	2,721	908	(7,141)	1,813
Cash flows from capital and related financing activities	5,585	(533)	106	6,118	(639)
Net change in cash and cash equivalents	(374)	556	(1,755)	(930)	2,311
Cash and cash equivalents at beginning of year	949	393	2,148	556	(1,755)
Cash and cash equivalents at end of year	$ 575	$ 949	$ 393	$ (374)	$ 556

Cash flows from operating activities reflect the net effect PUC's regular business activities had on cash and cash equivalents. FY2005 and FY2006 saw dramatic increases in the fuel price such that the existing fuel cost recovery mechanism (the Automatic Fuel Price Adjustment Clause) proved inadequate in responding to the fuel price increases on a timely basis. Fuel payments increased in FY2005 by 51% while cash receipts rose by only 42%. FY2006 witnessed an additional 23% increase in fuel payments while collections increased by only 11%. During FY2007, fuel price increases flattened to a tolerable rate at 4%. A compounding problem in FY2006 was the occurrence of several mechanical problems during the year resulting in additional maintenance cost of about $300K. All these factors resulted in a negative operating cash flow for both FY2005 and FY2006 of ($2.2 million) and ($3.6 million), respectively, while FY2007 realized a moderate positive cash flow of $156K.

Cash flows from investing activities reflect PUC's investments in long-term certificates of deposits (TCD) and securities. In FY2005, PUC acquired an additional TCD of $630K and realized interest and other income from investment related activities, resulting in a net reduction to cash and cash equivalents of $524K. In FY2006, PUC liquidated $2.9 million of its investments, $1 million of which was invested in a TCD with a local bank. The remaining balance of $1.9 million was the increase to cash and cash equivalents which was used for operations. In FY2007, investments and TCDs amounting to $3.7 million were liquidated to retire short-term debts. PUC also acquired a long-term loan during the year in the amount of $7 million. Proceeds of the loan, net of $1.6 million used to repair damaged generators and pay an initial installment on two mobile generators, were invested in securities. The net reduction to cash and cash equivalents from investing activities amounted to $1.7 million for FY2007.

Cash flows from non-capital financing activities reflect borrowings for non-capital activities and their repayments. PUC borrowed a net $908K in FY2005 and a net $2.8 million in FY2006 for operational purposes. In FY2007, with the liquidation of some of its TCDs and investments, PUC retired $4.4 million of its non-capital borrowings.

Cash flows from capital and related financing activities, on the other hand, reflect financing activities (borrowings and their repayments, interest on borrowings, grants, and contributions) that are related to capital purposes. Purchases of capital assets are also reflected in this category. In FY2005, PUC received $374K in grants of which $246K was invested in capital assets during the year resulting in a net increase to cash and cash equivalents of $106K. In FY2006, only $24K in grants was received while $557K of cash was invested in capital assets. Further, $121K was disbursed for interest on borrowings, resulting in a net decrease to cash and cash equivalents of $653K. During FY2007, as discussed above, PUC borrowed $7 million with $1.6 million of its proceeds disbursed to pay for an initial installment on two mobile generators and to repair existing generator units. PUC also disbursed $184K to cover interest on borrowings and received $125K in grant funds for capital purposes. The net increase to cash and cash equivalents amounted to $5.5 million for the year.

CAPITAL ASSETS

Capital Assets

Investment in capital assets has been minimal for the last three years due to tight cash flows. At the end of FY 2005, PUC had invested in a broad range of utility capital assets, including its power generation plants, electric transmission and distribution, and general support and administrative equipment, a cumulative $48.1 million. PUC's investment in capital assets increased to $48.4 million at the end of FY2006 and further increased to $49.8 million by end of FY2007. Net value after depreciation was $30.6 million, $28.7 million, and $27.6 million for FY2005, FY2006, and FY2007, respectively.

The following table summarizes PUC's capital assets by category and accumulated depreciation, and the changes therein for the years ended September 30, 2007, 2006, and 2005, respectively.

Table 4

CAPITAL ASSETS AND ACCUMULATED DEPRECIATION
(Dollars in Thousands)

CAPITAL ASSETS:	Sept 30, 2007	Sept 30, 2006	Sept 30, 2005	Increase (Decrease) 2007 to 2006	Increase (Decrease) 2006 to 2005
Electric Plants:					
Electric Plants, Koror/Aimeliik	$ 22,969	$ 22,971	$ 22,972	$ (2)	$ (1)
Electric Plants, Outlying States	2,378	2,378	2,378	-	-
Total Electric Plants	25,347	25,349	25,350	(2)	(1)
Accumulated Depreciation	(13,463)	(11,955)	(10,446)	1,508	1,509
Net Electric Plant	11,884	13,394	14,904	(1,510)	(1,510)

	Sept 30, 2007	Sept 30, 2006	Sept 30, 2005	Increase (Decrease) 2007 to 2006	Increase (Decrease) 2006 to 2005
Transmission & Distribution System					
T&D System, Koror/Aimeliik	17,182	17,182	17,182	-	-
T&D System, Outlying States	2,090	2,090	2,090	-	-
Total T&D System	19,272	19,272	19,272	-	-
Accumulated Depreciation	(6,516)	(5,845)	(5,143)	671	702
Net T&D System	12,756	13,427	14,129	(671)	(702)
Administrative Equipment					
Buildings	894	808	716	86	92
Heavy Equipment & Vehicles	1,555	1,554	1,379	1	175
Tools & Maint Equipment	787	787	786	-	1
Computers & Office Equipment	590	559	583	31	(24)
Total Admin Equipment	3,826	3,708	3,464	118	244
Accumulated Depreciation	(2,246)	(1,980)	(1,907)	266	73
Net Admin Equipment	1,580	1,728	1,557	(148)	171
Capital Improvement Projects:					
Mobile CAT Generators	1,378	-	-	1,378	-
PUC Office Building	-	-	4	-	(4)
PDD Mechanic Shop	-	103	-	(103)	103
APP Waste Oil Containment Building	-	-	14	-	(14)
Total Capital Projects in Progress	1,378	103	18	1,275	85
TOTAL FIXED ASSETS	$ 27,598	$ 28,652	$ 30,608	$ (1,054)	$ (1,956)

The following major Capital Improvement Projects were completed during fiscal years 2005, 2006, and 2007, respectively:

FY2005:	SCADA Controlled Switching System	$457,215
	Airai Substation Switchgear Replacement	$166,312
FY2006:	Warehouse Extension-PDD	$ 67,720
	APP Waste Oil Containment Building	$ 20,523
FY2007:	PDD Mechanic Shop	$103,551

Ongoing Capital Improvement Project at the end of FY2007 was:
Mobile CAT Generators (2 units) $1,378,026

A project to construct a PUC Office Building was initiated in FY2005. The contract has been rescinded and the advance made on the project has been reclassified as a receivable from contractor of $135K (net of an allowance of $131K) and $266K at the end of FY2007 and FY2006, respectively.

Please refer to Note 6 to the financial statements for more information on activity with respect to PUC's capital assets.

FINANCING ACTIVITES

PUC financing activities acquired a $7 million loan in FY2007 to finance a new 5MW generator to supplement the existing but aging 25MW plant. Negotiations are underway for execution of the project.

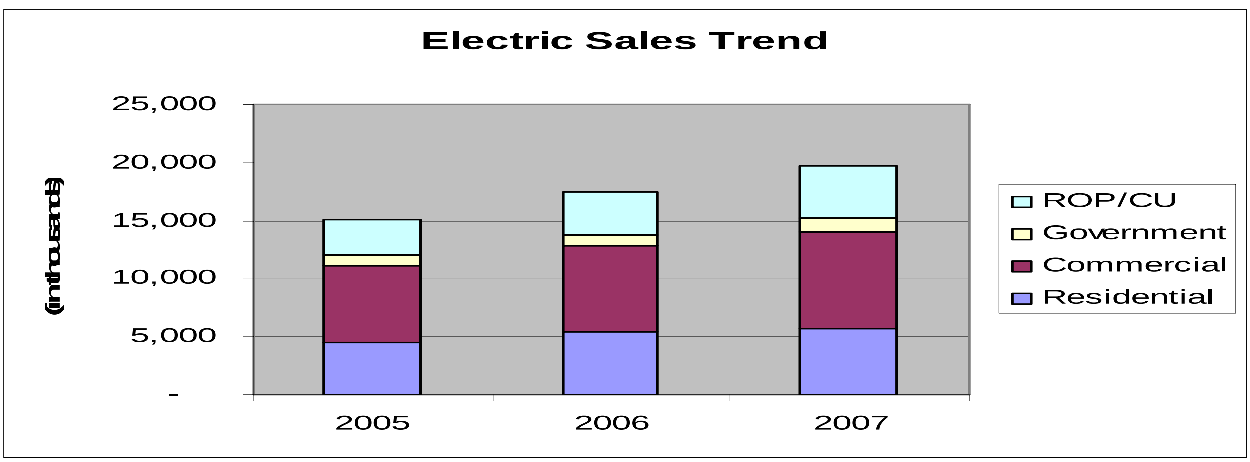
A Five-Year Strategic Plan, adopted by the Board of Directors of PUC on October 30, 2003 provided guidance for the replacement and upgrade of the existing infrastructure up to the current fiscal year. In FY2008, a long-term master plan study has been undertaken to assist PUC in managing its infrastructure to meet power demand up to year 2025. The plan will detail major capital improvements to PUC's power generating plants and transmission and distribution systems in tandem with projected growth demand.

Please refer to Note 7 to the financial statements for additional information on PUC's financing activities.

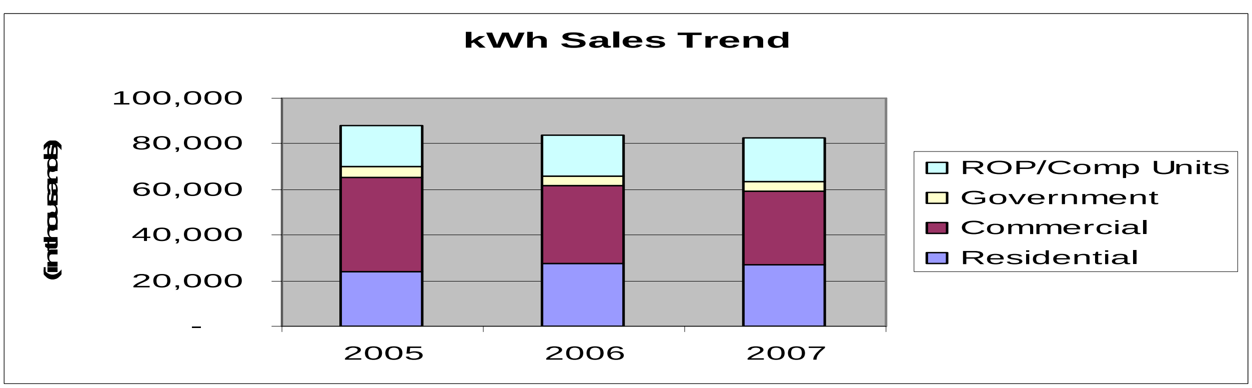
ECONOMIC FACTORS

SALES

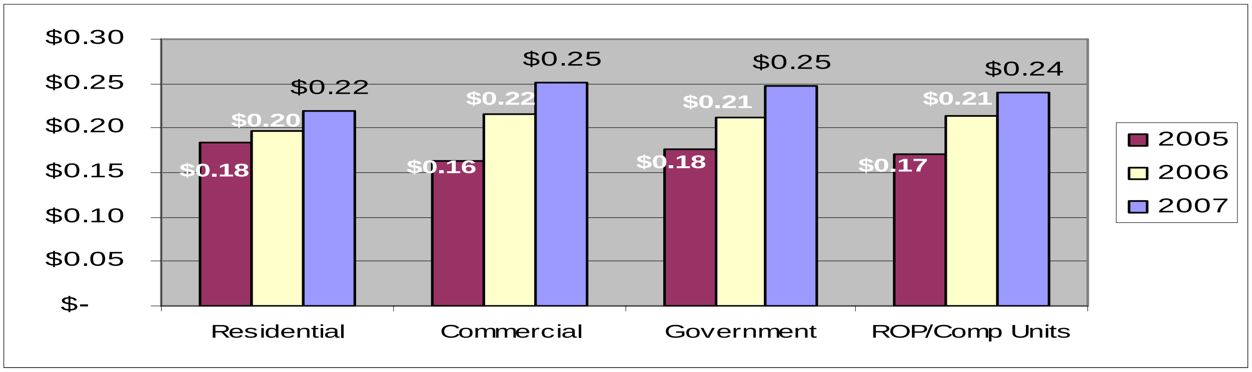
Electric sales for the past three years has shown a continuous growth trend ranging from 13%-16%. This has been due primarily to rate increases triggered by the rapidly rising fuel price. Sales in kWh units actually show a decline in the last two years due in part to the rising electricity cost. Anticipated sales growth has not materialized as yet despite the completion of the Compact Road on the big island. Factors such as rise in cost of living and economic conditions have contributed to this leveled performance. The charts below illustrate the trend of operations by comparing annual electric sales, kWh sales, and rates per kWh over the last three years.



Overall gross sales grew by 28% in 2005, 16% in 2006, and 13% in 2007.



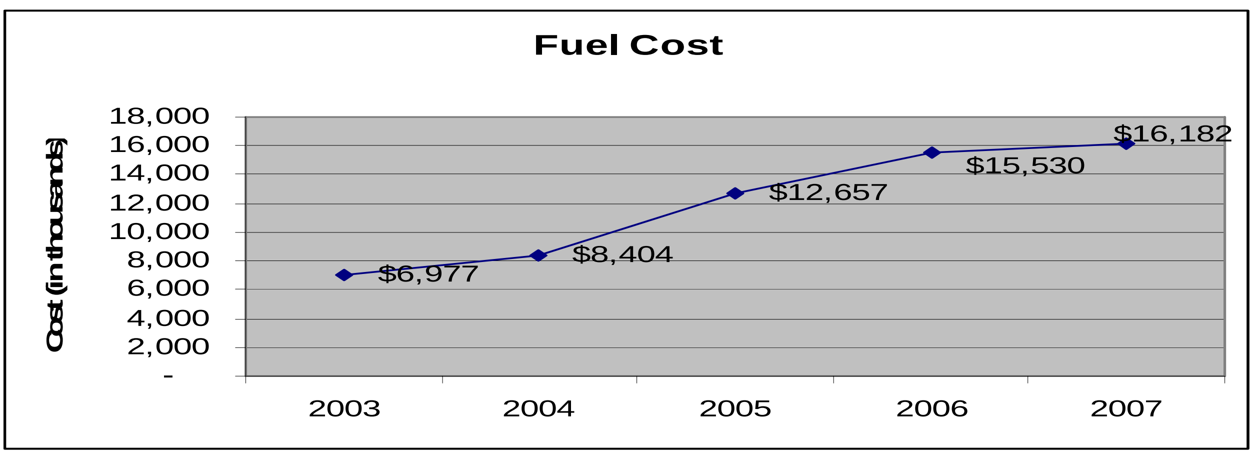
Overall kWh unit sales increased by 1% in FY2005, dropped by 5% in FY2006, and further declined by 1% in FY2007. The drop in FY2006 kWh unit sales is the result of power blackouts caused by the breakdown of two base-load generators.



Electric rates have steadily increased over the last three years in response to rising fuel cost. Based on fuel cost trend of the last six years (average annual increase of 26%), it is expected that electric rates will continue to climb as well. PUC's electric tariff in effect during these years incorporated an automatic fuel price adjustment mechanism that allowed for some recovery of fuel cost through rate increases post-occurrence. This mechanism has been improved upon to be more responsive to rising fuel cost in a timely manner after FY2007. The revised mechanism is expected to result in full recovery of fuel cost.

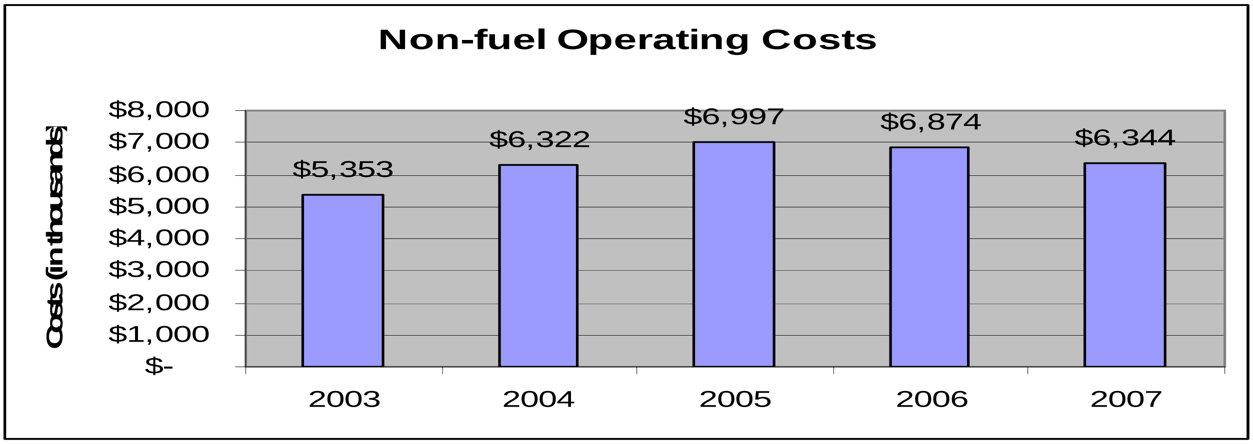
EXPENSES

Fuel cost now comprises over 70% of PUC's operating costs. The trend over the last five years has been mounting as shown in the following chart.



The above trend implies a continuous climb in the future. Management is taking every step possible to minimize loss and maximize generation efficiency.

Other operating costs, on the other hand, have remained relatively steady as shown below:



INFRASTRUCTURE

A newly devised master plan developed by a team of consultants anticipates a potential power demand growth of 4% by next year based on current economic indicators. As PUC progresses in its plans to upgrade the existing power infrastructure, management believes that operating costs could be curtailed with newer fuel-efficient systems. This, combined with anticipated growth, gives hope to a strong reliable power system and potential savings to PUC's customers.

CONTACTING PUC'S FINANCIAL MANAGEMENT

This financial report is designed to provide PUC's rate payers and creditors with a general overview of PUC's finances and to demonstrate PUC's accountability for the money it receives. If you have questions about this report, or need additional information, contact the PUC Accounting Department at the Palau Public Utilities Corporation, P.O. Box 1372, Koror, Republic of Palau 96940, or e-mail jacquia@ppuc.com or call 488-5320.

PUBLIC UTILITIES CORPORATION

Statements of Net Assets
September 30, 2007 and 2006

ASSETS	2007	2006
Utility plant:		
Electric plant	$ 25,346,861	$ 25,348,761
General support equipment	22,546,537	22,457,443
Administrative equipment	551,823	522,975
Utility plant in service	48,445,221	48,329,179
Accumulated depreciation	(22,224,923)	(19,780,665)
Net utility plant in service	26,220,298	28,548,514
Construction in progress	1,378,026	103,551
Net utility plant	27,598,324	28,652,065
Current assets:		
Cash and cash equivalents	574,854	949,100
Time certificates of deposit	636,794	1,955,342
Investments	6,925,951	8,107,680
Receivables:		
Trade	2,334,136	2,050,970
Vendor	372,099	372,099
Affiliate	866,739	490,620
Interest	16,078	60,224
Other	13,080	28,925
	3,602,132	3,002,838
Less allowance for doubtful accounts	(608,000)	(327,000)
Total receivables, net	2,994,132	2,675,838
Prepaid expenses	190,913	297,167
Inventory, net	3,861,897	3,564,635
Due from grantor agency	68,540	48,140
Total current assets	15,253,081	17,597,902
Other non-current assets:		
Restricted investments	5,393,718	-
Receivable from a local bank, net	1,058,378	2,004,055
Receivable from a contractor, net	134,794	265,794
Total other assets	6,586,890	2,269,849
	$ 49,438,295	$ 48,519,816

LIABILITIES AND NET ASSETS		
Net assets:		
Invested in capital assets, net of related debt	$ 26,918,075	$ 28,652,065
Unrestricted	11,963,941	13,071,960
Total net assets	38,882,016	41,724,025
Commitments and contingencies		
Current liabilities:		
Short-term borrowings	182,496	4,542,351
Accounts payable	2,499,287	1,428,500
Accrued expenses	278,668	270,894
Payable to affiliate	128,232	128,232
Customer deposits	451,424	409,642
Total current liabilities	3,540,107	6,779,619
Long-term debt	7,000,000	-
Other liabilities	16,172	16,172
Total liabilities	10,556,279	6,795,791
	$ 49,438,295	$ 48,519,816

See accompanying notes to financial statements.

PUBLIC UTILITIES CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2007 and 2006

	2007	2006
Operating revenues:		
Power	$ 19,708,689	$ 17,482,734
Other	307,587	321,351
Total operating revenues	20,016,276	17,804,085
Less provision for uncollectible receivables	(295,635)	(86,396)
Net operating revenues	19,720,641	17,717,689
Operating expenses:		
Generation - fuel	16,182,383	15,530,247
Depreciation	2,470,986	2,506,465
Generation - other cost	2,028,701	2,355,184
Administration	939,731	1,059,226
Distribution and transmission	787,235	786,834
Engineering services	117,598	166,334
Total operating expenses	22,526,634	22,404,290
Operating loss	(2,805,993)	(4,686,601)
Nonoperating revenues (expenses):		
Net increase in fair value of investments	1,152,923	535,366
Grant revenues	145,240	-
Interest income	87,504	184,569
Gain (loss) on disposal of assets	1,121	(6,525)
Writedown of receivable from a local bank	(1,000,000)	-
Interest expense	(260,021)	(123,565)
Writedown of receivable from a contractor	(131,000)	-
Other	(31,783)	83,531
Total nonoperating revenues (expenses), net	(36,016)	673,376
Change in net assets	(2,842,009)	(4,013,225)
Net assets at beginning of year	41,724,025	45,737,250
Net assets at end of year	$ 38,882,016	$ 41,724,025

See accompanying notes to financial statements.

PUBLIC UTILITIES CORPORATION

Statements of Cash Flows
Years Ended September 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Cash received from customers	$ 19,399,983	$ 16,600,578
Cash payments to suppliers for goods and services	(17,408,290)	(17,999,437)
Cash payments to employees for services	(1,835,347)	(2,189,594)
Net cash provided by (used for) operating activities	156,346	(3,588,453)
Cash flows from investing activities:		
Net change in time certificates of deposit	1,318,548	(1,118,425)
Interest received on time certificates of deposit	77,327	143,025
Other non-operating	(31,783)	80,762
Purchase of investment securities	(16,259,903)	(10,254,625)
Proceeds from sale and maturities of investment securities	12,743,230	12,864,967
Interest and dividends on investments	457,607	240,917
Net cash provided by (used for) investing activities	(1,694,974)	1,956,621
Cash flows from non-capital financing activities:		
Proceeds from short-term borrowings	-	3,516,319
Principal payment on short-term borrowings	(4,359,855)	(674,800)
Interest paid on short-term borrowings	(60,618)	(120,796)
Net cash provided by (used for) non-capital financing activities	(4,420,473)	2,720,723
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	7,000,000	-
Cash received from grantor agencies	124,840	24,499
Interest paid on long-term debt	(141,387)	-
Acquisition of utility plant	(1,398,598)	(556,829)
Net cash provided by (used for) capital and related financing activities	5,584,855	(532,330)
Net change in cash and cash equivalents	(374,246)	556,561
Cash and cash equivalents at beginning of year	949,100	392,539
Cash and cash equivalents at end of year	$ 574,854	$ 949,100
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	$ (2,805,993)	$ (4,686,601)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation	2,470,986	2,506,465
Provision for uncollectible receivables	295,635	86,396
Provision for inventory obsolescence	72,327	-
(Increase) decrease in assets:		
Receivables:		
Trade	(297,801)	(324,314)
Affiliate	(376,119)	146,667
Vendors	-	(372,099)
Other	15,845	(2,972)
Prepaid expenses	106,254	(229,864)
Inventory	(369,589)	(279,478)
Increase (decrease) in liabilities:		
Accounts payable	995,245	(466,744)
Accrued expenses	7,774	(13,137)
Customer deposits	41,782	47,228
Net cash provided by (used for) operating activities	$ 156,346	$ (3,588,453)

Non-cash transactions:

PUC recorded a net increase in fair value of investments of $1,152,923 and $535,366 for the years ended September 30, 2007 and 2006, respectively.

See accompanying notes to financial statements.

(1) Organization

The Public Utilities Corporation (PUC), a component unit of the Republic of Palau (ROP), was created on July 6, 1994, under the provisions of Republic of Palau Public Law (RPPL) 4-13. The law created a wholly-owned government corporation managed by a Board of Directors appointed by the President of the ROP, with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress). The primary purpose of PUC is to establish and operate electrical utility services within ROP.

PUC's financial statements are incorporated into the financial statements of ROP as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of PUC conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. PUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Estimates

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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Net Assets

Net assets represent the residual interest in PUC's assets after liabilities are deducted and consist of four sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable, and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All other net assets are unrestricted.

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash on hand, demand deposits and time certificates of deposit with original maturities of three months or less. Time certificates of deposit with original maturities greater than three months are separately classified.

Receivables

PUC grants credit, on an unsecured basis, to individuals, businesses and governmental entities situated in the Republic of Palau. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluation of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expense.

Investments

Investments are reported at fair value using quoted market prices. Fair value is the amount at which a financial instrument could be exchanged between willing parties, other than in a forced or liquidation sale.

Inventory

Inventories of fuel and supplies are stated at the lower of cost (first-in, first-out) or market (net realizable value).

Utility Plant

Utility plant is stated at cost. PUC capitalizes utility plant in excess of $500. Depreciation is provided using the straight line method over the estimated useful lives of the respective assets.

Capitalization of Interest

PUC capitalizes interest in order to recognize all costs associated with construction based on PUC's weighted average borrowing rate. During the year ended September 30, 2007, $17,526 of eligible interest was capitalized.

New Accounting Standards

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of PUC.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

Sales of Electricity

Sales of electricity are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing. Unbilled revenues at September 30, 2007 and 2006 were $887,502 and $945,039, respectively.

Retirement Plan

PUC contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multi-employer pension plan established and administered by the Republic of Palau.

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan, Continued

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau, Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer. PUC contributed $164,789, $161,866 and $148,362 to the Fund during the fiscal years 2007, 2006 and 2005, respectively.

Under the provisions of RPPL 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation Plan which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. PUC's total payroll, except expatriate workers, for fiscal years 2007 and 2006 is covered by the Fund's plan. The Fund utilizes the actuarial cost method termed "aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 8.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement, and (c) an assumption that members retire at the earlier of age 60 or upon attaining 30 years of service.

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employment service to date. The measure is intended to assist users to evaluate the Fund's funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

The Fund's October 1, 2005 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	$ 47,711,000
Active participants	33,893,000
Participants with vested deferred benefits	1,565,000
Total pension benefit obligation	83,169,000
Net assets available for benefits, at market value	41,965,000
Unfunded benefit obligation	$ 41,204,000

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor. Accordingly, no liability has been recorded for any unfunded benefit obligation by PUC.

Taxes

Based on enactment of RPPL 4-13, PUC is exempt from all national and state non-payroll taxes or fees.

(2) Summary of Significant Accounting Policies, Continued

Compensated Absences

Accumulated unpaid annual leave is accrued when earned and is included in the statements of net assets as an accrued expense. Accumulated unused sick pay benefit is accrued at 25% of the sick leave hours recorded times the employee regular base rate, and is included in the statements of net assets as an accrued expense.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses include all direct and administrative revenues and expenses associated with the generation and distribution of electricity to customers in the Republic of Palau.

Non-operating revenues and expenses result from investing and financing activities, including operating and capital grants from other governmental entities.

Reclassifications

Certain reclassifications have been made to the 2006 financial statements to correspond with the 2007 presentation.

(3) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 Deposits that are federally insured or collateralized with securities held by PUC or its agent in PUC's name;

Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in PUC's name; or

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in PUC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, PUC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. PUC does not have a deposit policy for custodial credit risk.

(3) Deposits and Investments, Continued

Deposits, Continued

As of September 30, 2007 and 2006, cash and cash equivalents and time certificates of deposit were \$2,270,026 and \$4,908,497, respectively, and the corresponding bank balances were \$4,481,639 and \$6,267,984, respectively. Of these amounts, \$2,423,261 and \$4,257,521, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007 and 2006, bank deposits in the amount of \$187,260 and \$149,610, respectively, were FDIC insured. PUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage and deposits in financial institutions not subject to FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1 Investments that are insured or registered, or securities held by PUC or its agent in PUC's name;

Category 2 Investments that are uninsured or unregistered for which the securities are held by the counterparty's trust department or agent in PUC's name; or

Category 3 Investments that are uninsured and unregistered with securities held by the counterparty, or by its trust department or agent but not in PUC's name.

GASB Statement No. 40 amended GASB Statement No. 3 to eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks for investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial risk in GASB Statement No. 3.

The following investment policy governs the investment of assets of PUC.

General:

a. Any restrictions set forth by applicable law governing allocation limits, size, or quality of investments, if more stringent than PUC's investment policy, will be the governing restriction.

b. No investment management organization shall have more than 40% of the Capital Investment Reserves Fund.

c. U.S. and non-U.S. common stocks, American Depository Receipts, convertible bonds, preferred stocks, fixed income securities, mutual funds and short-term securities are permissible investments.

d. No individual security of any issuer, other than that of the U.S. Government, shall constitute more than 10% (at cost) of any investment manager's portfolio.

(3) Deposits and Investments, Continued

Investments, Continued

General:, Continued

e. The following securities and transactions are not authorized without prior Board approval: letter stock and other unregistered securities; non-negotiable securities; commodities or other commodity contracts; short sales; margin transactions; and options and futures.

Equities:

a. Consistent with the desire to maintain broad diversification, allocations to any economic or industry sector should not be excessive.

b. Equity holdings shall be restricted to readily marketable securities of corporations that are actively traded on major exchanges.

c. Investment managers shall have the discretion to invest a portion of the assets in cash reserves when they deem appropriate. However, the investment managers will be evaluated against their peers on the performance of the total funds under their direct management.

d. Common stock and preferred stock of any institution or entity created or existing under the laws of the United States or any state, district, territory, or any foreign country are permissible investments.

Fixed Income:

a. All fixed income securities held in the portfolio shall have a Moody's or Standard & Poor's credit quality rating of no less than "BBB". U.S. Treasury and Agency securities, while non-rated, qualify for inclusion in the portfolio.

b. No more than 20% of the market value of the portfolio shall be rated less than single "A" quality, unless the manager has specific written authorization. 80% of the fixed income portfolio must be in bonds of credit quality equal to or greater than "A".

c. The total portfolio quality (capitalization weighted) shall maintain an "A" minimum rating.

d. It is the Policy of the Board to place assets in local certificates of deposit (Local CDs) issued by local banking institutions, with the express purpose of making funds available to the local community in the form of loans. While these local CDs are held, they will be included in the "strategic asset allocation" as fixed income investments. However, these local CDs and the local banking institutions must meet the following criteria on an ongoing basis: (1) The local CDs must offer a competitive return relative to alternative issuers; and (2) the local banking institutions must provide quarterly financial statements for Investment Committee review. The Investment Committee is charged with monitoring the financial health of the local banking institutions. Should concerns arise with respect to the financial condition of the local banking institutions, the Investment Committee will immediately notify the Board so that appropriate action can be determined and taken.

(3) Deposits and Investments, Continued

Investments, Continued

Cash and Equivalents:

a. U.S. Government obligations, U.S. Government agency obligations, and U.S. Government instrumentality obligations are permissible.

b. All commercial paper issuers must maintain an "A1" rating by Standard & Poor's and a "P-1" rating by Moody's Investor Service and be issued by corporations domiciled within the United States having total assets in excess of one billion dollars.

c. All certificate of deposit issuers must have a minimum capital of ten million dollars.

d. Repurchase agreements must be collateralized with either: (1) U.S. Treasury or Agency Securities with a market value of 102%, marked to market daily; or, (2) money market instruments which meet the qualifications of the investment policy statement and with a market value of 102%, marked to market daily.

e. Money market funds must be registered with the Securities and Exchange Commission under the Investment Company Act of 1940.

f. No single issue shall have a maturity of greater than one year.

g. The money market funds must have an average maturity of less than one year.

GASB Statement No. 40 requires entities to provide information about the credit risk associated with their investments by disclosing the credit quality ratings.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, PUC will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. As of September 30, 2007 and 2006, PUC's investments are held and administered by investment managers subject to Securities Investor Protection Corporation insurance in accordance with PUC's investment policy.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments.

As of September 30, 2007 and 2006, investments at fair value are as follows:

	2007	2006
Fixed income securities	$ 3,826,260	$ 3,639,980
Other investments:		
Domestic equities	3,842,270	4,146,711
Others	4,651,139	320,989
	8,493,409	4,467,700
	$ 12,319,669	$ 8,107,680

(3) Deposits and Investments, Continued

Investments, Continued

PUC's restricted investments as of September 30, 2007 amounting to $5,393,718 represents unspent portion of the loan proceeds from PUC's loan with a foreign bank (see Note 7).

As of September 30, 2007, PUC's fixed income securities had the following maturities:

		Investment Maturities (in years)				
Investment Type	Fair Value	Less than 1 year	1 - 5	6-10	More than 10	Rating
U.S. Treasury Notes	$ 2,340,920	$ 30,009	$ 1,927,135	$ 298,965	$ 84,811	AAA
Other obligations of U.S. Government and Agencies	433,624	-	-	-	433,624	AAA
Corporate Bonds	121,072	-		90,198	30,874	AAA
Corporate Bonds	39,223	-	-	-	39,223	AA
Corporate Bonds	175,755	-	71,104	104,651	-	AA-
Corporate Bonds	106,213	-	31,416	38,249	36,548	A+
Corporate Bonds	74,325	-	-	34,831	39,494	A
Corporate Bonds	77,075	-	-	-	77,075	A-
Corporate Bonds	146,652	-	-	73,691	72,961	BBB+
Corporate Bonds	104,323	-	-	104,323	-	BBB
Corporate Bonds	71,621	-	-	36,091	35,530	BBB-
International Bonds	40,317	-	-	-	40,317	AA-
International Bonds	71,416	-	36,273	-	35,143	A-
International Bonds	23,724	-	-	-	23,724	BBB+
	$ 3,826,260	$ 30,009	$ 2,065,928	$ 780,999	$ 949,324	

As of September 30, 2006, PUC's fixed income securities had the following maturities:

		Investment Maturities (in years)				
Investment Type	Fair Value	Less than 1 year	1 - 5	6-10	More than 10	Rating
U.S. Treasury Notes	$ 1,735,105	$ 106,092	$ 1,270,209	$ 358,804	$ -	AAA
Other obligations of U.S. Government and Agencies	1,256,246	-	197,715	151,143	907,388	AAA
Corporate Bonds	51,412	-	-	51,412	-	AAA
Corporate Bonds	36,717	-	-	36,717	-	AA-
Corporate Bonds	64,419	-	32,468	31,951	-	A+
Corporate Bonds	137,240	-	-	137,240	-	A
Corporate Bonds	71,941	-	36,000	35,941	-	A-
Corporate Bonds	74,037	-	-	74,037	-	BBB+
Corporate Bonds	175,421	-	-	105,429	69,992	BBB
Corporate Bonds	37,442	-	-	37,442	-	BBB-
	$ 3,639,980	$ 106,092	$ 1,536,392	$ 1,020,116	$ 977,380	

(3) Deposits and Investments, Continued

Investments, Continued

Receivable from a Local Bank:

At September 30, 2007 and 2006, PUC has uninsured deposits of $1,058,378 (net of an allowance of $1 million) and $2,004,055, respectively, with a bank that went into receivership on November 7, 2006. These deposits are reflected as a receivable from a local bank in the accompanying statements of net assets.

(4) Due from Grantor Agency

PUC is a subrecipient of federal grants received by ROP from a U.S. federal agency. Excess grant disbursements over receipts are recognized as due from grantor agencies until funds are received in accordance with grant terms and conditions.

Changes in the due from grantor agency accounts for the years ended September 30, 2007 and 2006, are as follows:

	2007	2006
Balance at beginning of year	$ 48,140	$ 72,640
Deductions - cash receipts from grantor agencies	(124,840)	(28,000)
Additions - program outlays	145,240	3,500
Balance at end of year	$ 68,540	$ 48,140

(5) Inventory

Inventory at September 30, 2007 and 2006, consists of the following:

	2007	2006
Distribution and power plant supplies	$ 3,484,764	$ 3,031,274
Fuel	540,650	628,456
Lubricants	10,951	7,046
	4,036,365	3,666,776
Provision for slow moving inventory	(174,468)	(102,141)
	$ 3,861,897	$ 3,564,635

(6) Utility Plant and Construction In Progress

Utility plant and construction in progress consist of the following detailed balances at September 30, 2007 and 2006:

	Estimated Useful Lives	Balance at October 1, 2006	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2007
Electric plant	3 - 25 years	$ 25,348,761	$ -	$ (1,900)	$25,346,861
General support equipment	2 - 30 years	22,457,443	101,146	(12,052)	22,546,537
Administrative equipment	2 - 10 years	522,975	76,130	(47,282)	551,823
		48,329,179	177,276	(61,234)	48,445,221
Less accumulated depreciation		(19,780,665)	(2,470,986)	26,728	(22,224,923)
		28,548,514	(2,293,710)	(34,506)	26,220,298
Construction in progress		103,551	1,531,434	(256,959)	1,378,026
		$ 28,652,065	$ (762,276)	$ (291,465)	$ 27,598,324

	Estimated Useful Lives	Balance at October 1, 2005	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2006
Electric plant	3 - 25 years	$ 25,349,761	$ -	$ (1,000)	$ 25,348,761
General support equipment	2 - 30 years	22,188,912	493,082	(224,551)	22,457,443
Administrative equipment	2 - 10 years	547,352	31,675	(56,052)	522,975
		48,086,025	524,757	(281,603)	48,329,179
Less accumulated depreciation		(17,496,465)	(2,506,465)	222,265	(19,780,665)
		30,589,560	(1,981,708)	(59,338)	28,548,514
Construction in progress		18,666	103,551	(18,666)	103,551
		$ 30,608,226	$ (1,878,157)	$ (78,004)	$ 28,652,065

In 2006, the estimated useful lives of certain utility equipment were reduced as PUC determined this equipment would not be fully utilized through their original useful lives. The change in estimated useful lives resulted in an increase in depreciation expense of $161,430 for each of the years ended September 30, 2007 and 2006.

(7) Borrowings

Short-Term Borrowings

PUC entered into a revolving credit line agreement on March 14, 2005 under which a commercial bank will extend credit to PUC in the form of drawings, from time to time until March 14, 2006, in such sums as PUC may request but which shall not exceed $500,000 in the aggregate principal amount for the purpose of financing short-term working capital and to purchase equipment, generator parts, transmission and distribution system parts and any other purchases requiring letters of credit. Interest is subject to rate changes based on the interest rate paid on the deposit account and is payable monthly. On April 4, 2007, the revolving credit line agreement was amended to decrease the principal amount to $440,000 and to extend the credit term until March 1, 2008.

PUC entered into a term loan on December 23, 2004 in the amount of $1,800,000 for the purpose of financing short-term working capital. On October 6, 2005 the loan was refinanced for an additional $600,000 for the purpose of financing property improvements of its new office building. The loan bears a simple interest at a rate of 3.50% and 2.95% per annum as of September 30, 2007 and 2006. Principal balance is payable in quarterly $300,000 installments plus interest. The remaining balance of the loan as of September 30, 2007 is due in March 2008.

(7) Borrowings and Other Liabilities, Continued

Short-Term Borrowings, Continued

The revolving credit line and term loan are collateralized by time certificates of deposit, totaling $636,794 and $2,152,714, respectively.

PUC entered into a portfolio credit line agreement on May 30, 2006 under which a commercial bank will extend credit to PUC in the form of drawings from time to time in such sums as PUC may request for the purpose of financing short-term working capital. Interest rate is at 7.25% as of September 30, 2006. The portfolio credit line was fully repaid in December 2006.

Movements in short-term borrowings for the years ended September 30, 2007 and 2006, are as follows:

	Balance at October 1, 2006	Additions	Repayments	Balance at September 30, 2007
Term loan	$ 1,746,542	$ -	$ (1,564,046)	$ 182,496
Portfolio credit line	2,296,522	-	(2,296,522)	-
Credit line	499,287	-	(499,287)	-
	$ 4,542,351	$ -	$ (4,359,855)	$ 182,496

	Balance at October 1, 2005	Additions	Repayments	Balance at September 30, 2006
Portfolio credit line	$ -	$ 2,396,522	$ (100,000)	$ 2,296,522
Term Loan	1,199,485	850,000	(302,943)	1,746,542
Credit line	501,347	269,797	(271,857)	499,287
	$ 1,700,832	$ 3,516,319	$ (674,800)	$ 4,542,351

Long-Term Debt

On September 4, 2006, PUC entered into a loan agreement with a foreign bank not to exceed $7,000,000 with interest at 3.5% per annum to finance the purchase of portable generators, a crankshaft assembly and other necessary equipment to facilitate the overhaul of aging generators. The loan is guaranteed by the Republic of Palau and is to be repaid in thirty-five consecutive semi-annual installments in the principal amount of $200,000 plus interest; the first installment being repaid on the last day of the thirty-sixth month from the date of the initial advance and thereafter semi-annually on the last day of each successive six-month period, until fully paid.

(7) Borrowings and Other Liabilities, Continued

Principal payments for subsequent years ending September 30 and applicable interest due, are as follows:

Year Ending September 30,	Principal	Interest	Total
2008	$ -	$ 249,083	$ 249,083
2009	-	248,403	248,403
2010	400,000	240,547	640,547
2011	400,000	226,353	626,353
2012	400,000	212,742	612,742
2013 - 2017	2,000,000	848,303	2,848,303
2018 - 2022	2,000,000	493,286	2,493,286
2023 - 2027	1,800,000	140,428	1,940,428
	$ 7,000,000	$ 2,659,145	$ 9,659,145

Movements in long-term liabilities for the years ended September 30, 2007 and 2006, are as follows:

	Balance at October 1, 2006	Additions	Repayments	Balance at September 30, 2007
Long-term debt	$ -	$7,000,000	$ -	$7,000,000
Other liabilities	16,172	-	-	16,172
	$ 16,172	$7,000,000	$ -	$7,016,172

	Balance at October 1, 2005	Additions	Repayments	Balance at September 30, 2006
Other liabilities	$ 16,172	$ -	$ -	$ 16,172

(8) Related Party Transactions

PUC provides electrical utility services to ROP at the same rates charged to third parties. Balances receivable from and payable to ROP consist of the following at September 30, 2007 and 2006:

	2007	2006
Receivables:		
Utility services	$ 866,739	$ 490,620
Payable:		
Lapsed funding	$ 128,232	$ 128,232

Utility services rendered to ROP amounted to $4,494,016 and $3,757,613 for the years ended September 30, 2007 and 2006, respectively.

(9) Commitments

PUC entered into an agreement on October 14, 1999 with the Republic of Palau, State of Koror and Koror State Public Land Authority, in which PUC is granted the use and exclusive possession of real property located in Malakal (on which the Malakal Power Plant is located) for a term of thirty years. PUC is not required to pay any rent or fee for its use of the property.

PUC entered into a commercial supply agreement beginning February 1, 2005 and ending on January 31, 2010 in which PUC will purchase production and vehicle fuel and lubricants from a single contractor at an estimated amount of seven hundred thousand gallons of fuel per month. Purchase prices are based on movements of base price for fuel and lubricants.

PUC entered into an agreement on July 26, 2005 with the Airai State Public Lands Authority (ASPLA) to lease a lot to construct its office building. The lease is for an initial term of fifty years commencing on the date PUC occupies the premises following completion of the construction of its office building. Beginning on the third anniversary of the commencement of the lease term, PUC shall pay ASPLA $15,000 annually for a fifteen-year period. The fees for the remainder of the lease term will be negotiated after the eighteen-year period. Further, throughout the term of the lease, PUC shall provide ASPLA in-kind contributions up to a maximum of $6,000 annually. PUC has not commenced construction of its office building as of September 30, 2007.

Total future minimum lease payments for subsequent years ending September 30, are as follows:

Years ending September 30,	
2008	$ 15,000
2009	15,000
2010	15,000
2011	15,000
2012	15,000
2013 through 2017	75,000
2018 through 2022	75,000
	$ 225,000

(10) Contingencies

PUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, PUC will be self insured for the entire amount.

Under the provisions of RPPL 4-51, PUC shall credit from future electric utility charges the actual cost, including freight and insurance, incurred by any non-governmental electric utility customer, or incurred by any state government customer prior to the transfer of the Aimeliik Power Plant to PUC, to purchase transformers, cables, and meter bases necessary to connect such customer to the electric power distribution system; provided, however, that the customer is not entitled to such credit unless it has obtained written confirmation from PUC that the types of transformers, cables and meter bases are suitable to connect the customer to the electric power distribution system and that the proposed cost is reasonable. The expected credit from future electric utility charges cannot be presently determined and, accordingly, no provision for any credit has been recognized in the accompanying financial statements.

(10) Contingencies, Continued

PUC entered into a contract in October 2005 for the construction of an office building. A $265,794 advance payment was made based on the contract provisions. In 2006, management decided to put the construction on hold due to certain legalities of the contract. PUC is negotiating with the contractor to recover the advance payment. The amount that will be recovered cannot presently be determined. The advance payment made to the contractor is presented as receivable from a contractor in the accompanying statements of net assets and an allowance of $131,000 has been established as of September 30, 2007.

(11) Risk Management

PUC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. PUC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed, except for inventory and utility plant. Settled claims from insured risks have not exceeded commercial insurance coverage in the past three years.

(12) Subsequent Event

On June 20, 2008, RPPL 7-47 was enacted into law mandating ROP to earmark $3,000,000 to PUC. The grant shall be used to subsidize fuel charges to residential and commercial customers whose usage is no more than 500 or 2,000 kilowatt hours per month, respectively, so that amounts due from those customers will equal the effective rate on May 31, 2008. The subsidy shall remain in effect until the effective rate is reduced to May 31, 2008 levels or lower; or the date when the reduction in revenues to PUC caused by the credit reaches the amount of the grant, after which time the Electric Service Rate Schedules, effective June 5, 2008, shall go into effect.