

PROTECTED AREAS NETWORK FUND
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

INDEPENDENT AUDITORS' REPORT

Board of Directors
Protected Areas Network Fund:

Report on the Financial Statements

We have audited the accompanying financial statements of the Protected Areas Network Fund (PAN Fund), a component unit of the Republic of Palau, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Protected Areas Network Fund as of September 30, 2013 and 2012, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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 3 through 9 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. This supplementary information is the responsibility of PAN Fund's management. 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 5, 2014 on our consideration of PAN Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PAN Fund's internal control over financial reporting and compliance.

Debitte + Joubert LLC

May 5, 2014



Protected Areas Network Fund

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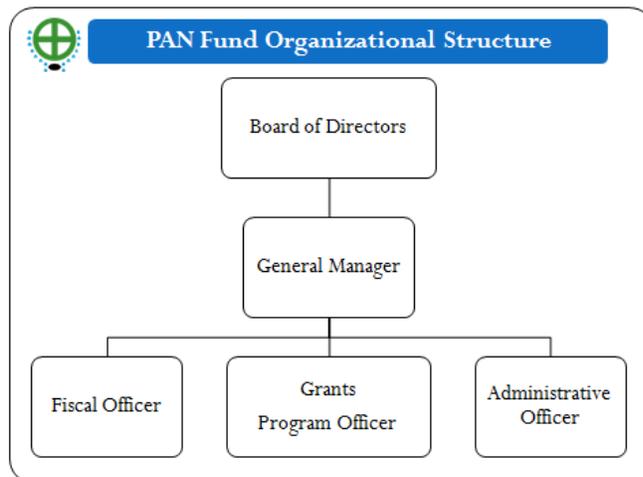
Fax: (680) 488-1314 | Website: www.palaupanfund.org

Management's Discussion and Analysis Year Ended September 30, 2013

This report presents a management's discussion and analysis of the Protected Areas Network Fund's (PAN Fund) financial performance during the fiscal year ended September 30, 2013, with selected comparative information for the fiscal year ended September 30, 2012 and for the period from inception (November 2, 2010) through September 30, 2011.

ORGANIZATION AND PURPOSE

PAN Fund is a registered non-profit corporation governed by a nine-member Board of Directors appointed by the initial four-member incorporators; namely The Nature Conservancy (TNC), Conservation International (CI), the Ministry of Natural Resources, Environment and Tourism (MNRET) and the Ministry of Finance (MOF) with advice and consent of the Senate of the Olbiil Era Kelulau (OEK-Palau National Congress). The Board of Directors' major responsibilities include governance, fiduciary and grant-making. Subsequent appointments of directors, other than an ex-officio director and a director appointed in accordance with the Articles of Incorporation, must be in accordance with procedures and regulations prescribed by the Board of Directors.



Republic of Palau Public Law (RPPL) 6-39 (the PAN Act) established a national system of support from the National Government of Palau to the States for its conservation programs to preserve, conserve and manage its natural resources and ecological biodiversity. RPPL 7-42 was then enacted creating a national financial mechanism and PAN Fund. The purpose of PAN Fund is to serve as a financial trustee corporation for all monies received for the PAN, to support and finance PAN projects and programs thus administering, managing, fundraising, investing, monitoring and disbursing PAN monies for the financial sustainability of the PAN in Palau for conservation of ecological biodiversity and sustainable management and use of its natural

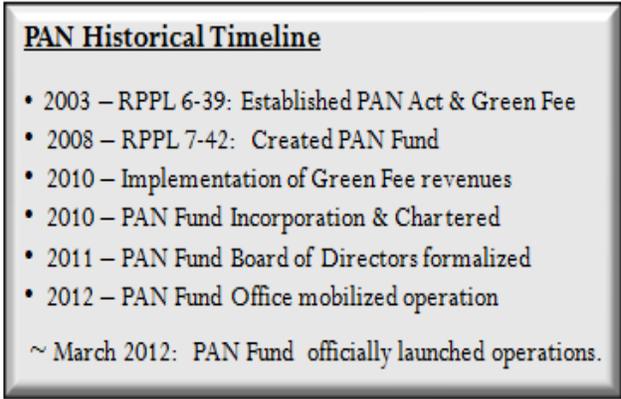
resources. These enabling legislations were published under Title 24 PNC Chapter 34 - Protected Areas Network.

The mission of PAN Fund is to “efficiently and equitably provide funding to the Protected Areas Network, and its associated activities, through strategic actions and medium- to long-term financial support that will advance effective management and conservation of Palau’s natural and cultural resources.” The funding priorities for the PAN are driven by Palau’s goals to establish and operationalize the PAN as promulgated by RPPL 6-39 and 7-42, where 100% of the monies are to be used to support and operationalize the PAN. The PAN serves as the national strategy to meet the goals of the Micronesia Challenge (MC) and achieve its goals on the Program of Works on Protected Areas (PoWPA) under the United Nations Convention on Biological Diversity (United Nations CBD).¹ The MC is a regional initiative with commitments by the Chief Executives of the Republic of Palau (ROP), the Federated States of Micronesia, the Republic of the Marshall Islands, the Territory of Guam and the Commonwealth of the Northern Mariana Islands with a goal to effectively conserve at least 30% of the near-shore marine and 20% of the terrestrial resources across Micronesia by the year 2020.

¹ Country Program Strategy for Palau’s MC Endowment Fund

In May 2008, RPPL 7-42 promulgated the creation of PAN Fund as a sustainable finance mechanism for the PAN. The implementation of “green fee” revenues became effective November 2010 and within the same period, the incorporation of PAN Fund’s corporate charter was established; however, PAN Fund’s operation commenced in March 2012 when PAN Fund received the initial operating “green fee” monies.

The green fee revenue is an environmental impact fee generated from two points of entry: the ocean and airports. The environment impact fee or what is commonly known as “green fee” for the PAN is \$15 per non-Palauan passport holder visiting Palau. The total green fee revenue is collected by the Bureau of Revenues, Customs and Taxation under the MOF. The MOF then transfers the revenues to PAN Fund in accordance with PAN regulations and established procedural agreements.



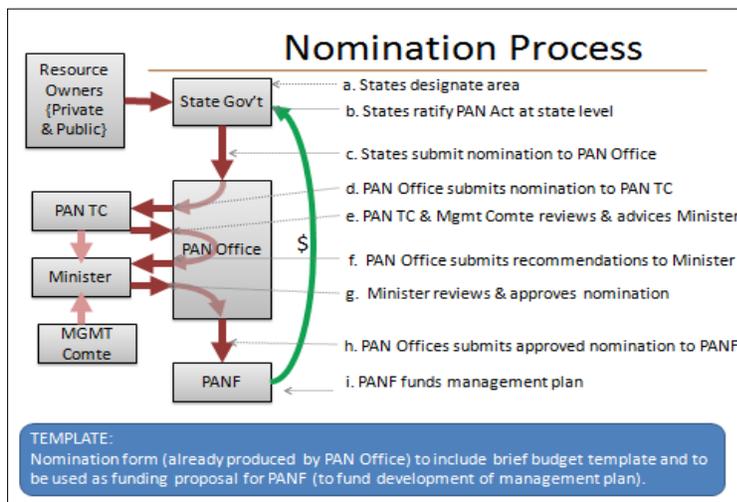
The publication of Title 24 PNC Chapter 34 creating an enabling legal infrastructure for the PAN was a long, methodically thought-out and challenging process; however, the challenges and delays provided an opportunity and served as an advantage for the PAN, where the green fee revenues commenced in November 2010, while formal operations began in March 2012. Hence,

PAN Fund had accumulated capital to initiate, impulse and support the PAN’s sustainable finance plan, while the green fee revenue generated and realized from previous years provided a predetermined budget for the following year’s operation. Therefore, PAN Fund and the PAN began operations with financial capital to implement its missions, goals and objectives.

In 2010, the first piloted conservation areas as members of the PAN Member States included:

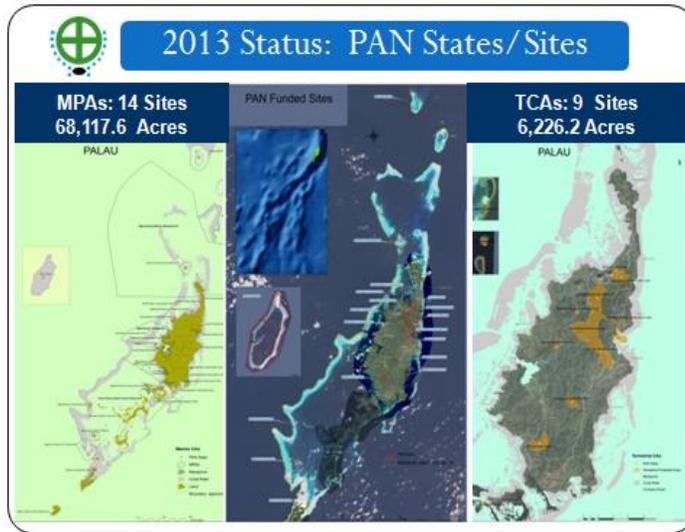
- Melekeok State - Ngardok Nature Reserve
- Hatohobei State - Helen Reef Conservation Area
- Ngarchelong State - Ebiil Channel Conservation Area
- Ngiwal State - Ngemai Marine Area and Oselkesol Watershed/Terrestrial Area

In accordance with Title 24 PNC Chapter 34 and PAN regulations, there are requirements for eligibility and access to the fiscal and technical support administered and entrusted to PAN Fund. The requirements includes a nomination process with procedural, scientific review and assessment of the nominated conservation area(s), establishment of supporting State level legislations for the conservation area and a conservation area management plan. However, the management and ownership of the natural resources remains with the State and community with high vested interest for a successful conservation management program. The first four pioneering PAN Member States received \$50,000 from green fee monies to support and finance each respective management plan.



The nomination process involves the PAN institutional members such as the Management Planning Unit (MPU) comprised of the PAN Office, the PAN Technical Committee, the PAN Management Committee and the MNRET. Once the nomination of the site is approved and endorsed by the Minister of MNRET, the State becomes a member of the PAN and becomes eligible to receive fiscal and technical support from PAN Fund. Eligibility for PAN monies/“green fees” include, but are not limited to, fiscal support for sites’ ecological baseline studies and drafting and implementation of management plans.

In 2012, PAN Member States increased to nine communities/States with combinations of conservation areas or systems of conservation areas with direct financial support of \$811,000 to operationalize the respective conservation management programs. As of September 30, 2013, PAN Member States increased to thirteen States with fourteen marine conservation areas and nine terrestrial conservation sites. The conservation area/sites vary in scope with targeted and specific conservation management plans for either marine or terrestrial areas, ecological services or system from marine and terrestrial, where some are “ridge to reef”, while other management plans incorporate a network of conservation programs. The inclusion of the three remaining States would comprehensively include all sixteen States in Palau, namely Anguar, Sonsorol and Ngatpang.

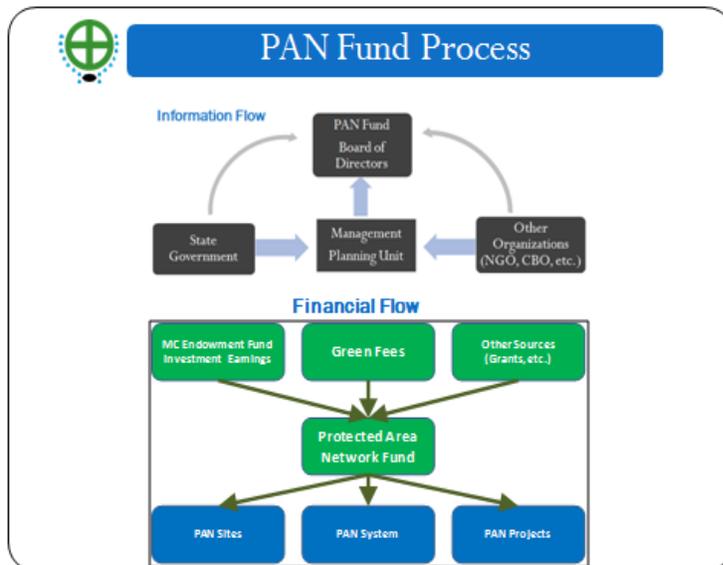


The conservation area/sites vary in scope with targeted and specific conservation management plans for either marine or terrestrial areas, ecological services or system from marine and terrestrial, where some are “ridge to reef”, while other management plans incorporate a network of conservation programs. The inclusion of the three remaining States would comprehensively include all sixteen States in Palau, namely Anguar, Sonsorol and Ngatpang.

A sustainable finance plan, with a comprehensive cost analysis factoring inclusion of all sixteen States of Palau, indicates an annual cost of \$2.5 million².

An updated cost analysis in 2012 reflected an increase of 28% to \$3.2 million per annum.

The direct management cost per management’s plans to operationalize the existing thirteen PAN Member States amounts to \$2.5 million. Factoring in the \$1.8 million annual green fee revenue in 2012, the financial gap is \$700,000 for an effective management program for PAN Member States, excluding financial assistance for the system-wide network or the PAN Institutional System that provides the technical support for the PAN Member States, such as the PAN Office, the PAN Technical Committee, the PAN Management Committee and other collaborating and supporting partners in the public sector (i.e., Palau International Coral Reef Center (PICRC), the Belau National Museum, Cultural Affairs, etc.) and the private sector (i.e., NGOs and CBOs such as the Palau Conservation Society (PCS), the Association of PAN Conservation Officers and “eldebechel”) with the communities.

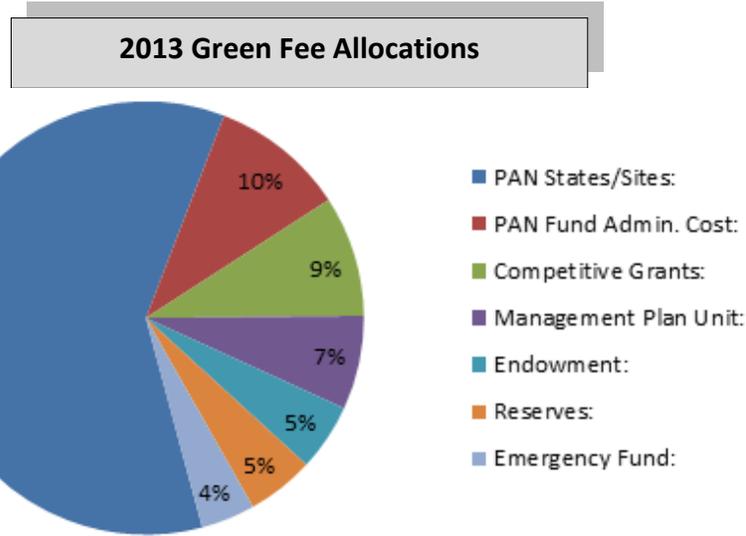


The “green fee” or environmental impact fee allocation and distribution to the PAN Member States is based on the amount specified in the management plans required to effectively implement each respective conservation program for the thirteen States. The disbursement of funds is subject to verification of activities and program implementation with the requirement for quarterly and annual reports. Therefore, PAN generated “green fee” monies are being utilized to finance, support and further the PAN’s conservation programs and economic development of Palau. These constitute an economic subsidy to further the cause of conservation programs, including, but not limited to, job creation, institutional capacity building (i.e., legislative infrastructure and enforcement

programs), capacity building to train and build the workforce for effective conservation management programs in areas of program management, public awareness and socialization, surveillance, enforcement programs and biological monitoring programs to achieve the MC 30/20 goals by 2020.

² MC Sustainable Finance Plan

Funding programs with allocations for 2013 PAN in accordance with PAN’s sustainable financing programs and legislative mandates per Title 24 PNC Chapter 34 and RPPL 8-18 are as follows:



60% of green fees are directly funding the PAN Member States’ conservation management programs. Emergency (4%) and legal reserves (5%) are restricted funds that are allocated for programs prescribed and mandated by Title 24 PNC Chapter 34 and PAN Fund operation programs to build a resilient financial mechanism to sustainably support PAN conservation and management programs. The strategic and diversification of allocated funding programs serves to offset fluctuations of “green fee” associated with the tourism industry and mitigate risks associated with emergencies (i.e., dangers with enforcement and surveillance) and natural disasters such as the effects of climate change, including Super Typhoons Bopha and Haiyan experienced in Palau.

The endowment (5%) is a contribution per RPPL 8-18 to Palau’s portion of the contributions held with the Micronesia Conservation Trust (MCT) in support of the MC Regional initiative, managed by MCT. Competitive grants program (9%) supports institutional system-wide programs for capacity building on enforcement programs and conservation management programs such as programmatic and financial reporting as well as scientific monitoring for baseline assessments. The technical support through the competitive grant for PAN Institutional System members, such as PCS and PICRC support the PAN Member States conservation programs at various ranges and degrees of mobilization and program implementation. The MPU (7%) includes the support for PAN system-wide program management and coordination, inclusive of the PAN Office, the PAN Technical Committee and the PAN Management Committee while PAN Fund administrative costs do not exceed 10% as per Title 24 PNC Chapter 34.

OVERVIEW OF FINANCIAL STATEMENTS

PAN Fund supports measures and initiatives to minimize carbon footprints with climate change mitigation. The effort is practiced with PAN Fund’s voluntary investment in energy efficient technology and equipment for operations. PAN Fund’s fixed assets were \$18,684 as of September 30, 2013 as compared to \$10,664 as of September 30, 2012. See note 3 for more detailed information on PAN Fund’s fixed assets and changes therein.

Statements of Net Position:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current assets	\$ 2,595,052	\$ 2,035,705	\$ 2,444,061
Fixed assets	<u>18,684</u>	<u>10,664</u>	<u>-</u>
Total assets	<u>2,613,736</u>	<u>2,046,369</u>	<u>2,444,061</u>
Current liabilities	<u>89,955</u>	<u>-</u>	<u>-</u>

OVERVIEW OF FINANCIAL STATEMENTS, CONTINUED

Statements of Net Position, Continued:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net position:			
Invested in capital assets	18,684	10,664	-
Restricted	<u>2,505,097</u>	<u>2,035,705</u>	<u>2,444,061</u>
Total net position	\$ <u>2,523,781</u>	\$ <u>2,046,369</u>	\$ <u>2,444,061</u>

Statements of Revenues, Expenses and Changes in Net Position:

Operating revenues	\$ -	\$ -	\$ -
Operating expenses	<u>1,232,842</u>	<u>2,245,612</u>	<u>302,147</u>
Operating loss	(1,232,842)	(2,245,612)	(302,147)
Nonoperating revenues	<u>1,710,254</u>	<u>1,847,920</u>	<u>2,746,208</u>
Change in net position	477,412	(397,692)	2,444,061
Net position at beginning of year	<u>2,046,369</u>	<u>2,444,061</u>	-
Net position at end of year	\$ <u>2,523,781</u>	\$ <u>2,046,369</u>	\$ <u>2,444,061</u>

Statements of Cash Flows:

Cash flows from operating activities	\$ (1,143,473)	\$ (2,245,612)	\$ (302,147)
Cash flows from noncapital financing activities	3,111,759	2,422,280	302,147
Cash flows from capital financing activities	<u>(10,456)</u>	<u>(10,664)</u>	<u>-</u>
Net increase in cash	1,957,830	166,004	-
Cash at beginning of year	<u>166,004</u>	-	-
Cash at end of year	\$ <u>2,123,834</u>	\$ <u>166,004</u>	\$ <u>-</u>

FINANCIAL HIGHLIGHTS

- Total assets of \$2,613,736 include accounts receivable to be transferred from ROP to PAN Fund of \$468,196. Green fee revenues decreased by 8% in fiscal year 2013 at \$1,706,923 compared to \$1,847,920 in fiscal year 2012. Green fee revenues of \$1,847,920 from fiscal year 2012 financed PAN Fund's operations in fiscal year 2013, while \$1,706,923 from fiscal year end 2013 are earmarked to finance PAN Fund's operations in fiscal year 2014.
- Operating expenses in 2013 reflects a full fiscal operating cycle, while 2012 reflects half a year's operations. To operationalize PAN Fund, 8% of green fees, or \$129,354, was used for the PAN Institutional System which includes the PAN Management Committee, PAN Technical Committee and the PAN Office, the coordinating and implementing arm of PAN Fund. The PAN Institutional System is a network of technical advisory and support for PAN Fund. In addition, 48% of green fees, or \$813,460, supported the thirteen communities or PAN Member States to implement each respective management plan and conservation program. To further support PAN Fund, competitive grants in the amount of \$44,226 were used to support capacity building for PAN Member States and to train and/or retrain the work force on biological monitoring by PICRC, while PCS was awarded a grant to support PAN Member States on capacity building, specifically on programmatic and financial reporting, as well as assessing and measuring the effectiveness of management plan implementation by the PAN Member States.
- Although 2013 operating expenses covers a full fiscal year cycle compared to the six months operating timeframe in 2012, total operating expenses in fiscal year 2013 are \$1,232,842 compared to \$2,245,612 in fiscal year 2012. The significant decrease of total operating expenses by 45% in 2013 is mainly due to the reduction of contributions held with MCT to the Palau PAN. In 2012, \$1,400,000 was transferred to MCT to build up the contributions held with MCT in compliance with the PAN legislation, specifically RPPL 8-18. The transfer of funds concurrently met the legislation requirement and Palau's commitment for a 2 to 1 matching program in support of the PAN with donor contributions by TNC. TNC pledged and contributed \$2,000,000, while Palau matched the pledge with \$4,000,000 with the infusion of the \$1,400,000 contributions held with MCT to the Palau PAN. The contribution to MCT from PAN Fund returned at a rate per RPPL 8-18 of 5% of green fee revenues, which in 2013 amounted to \$84,596.

FINANCIAL HIGHLIGHTS, CONTINUED

- The Palau PAN contributions held with MCT as of September 30, 2013 is \$6,888,443. The annual contribution of 5% of green fee revenue to MCT to build up the PAN contributions held with MCT is a commitment in support of the PAN's sustainable finance plan. Net investment returns are due to PAN Fund to fund the PAN; however, the investment returns are being rolled over annually to grow the contributions held with MCT. The target amount for the contributions held with MCT is \$10,000,000 to reach a sustainable draw of annual investment returns of at least \$500,000 to bridge the financial gap needed to support and finance the PAN's effective management of Palau's natural resources and ecological biodiversity conservation programs.
- Total cash flows from ROP of \$3,108,428 are inclusive of green fee revenues generated in fiscal year 2012 in the amount of \$1,847,920 which was utilized to operate PAN Fund in fiscal year 2013 and green fee revenues of \$1,706,923 realized during fiscal year 2013 are earmarked and restricted for PAN Fund operations in fiscal year 2014. Net cash of \$2,123,834 includes allocated and earmarked funds for competitive grants and PAN Member States' management plans with specific work plans and budgets for implementation. Delays in disbursement of funds is reflective of the various degrees and levels of program mobilization and implementation by the thirteen PAN Member States and competitive grants programs as disbursements are on a quarterly basis and subject to acceptable quarterly and annual reports.

ECONOMIC OUTLOOK

Conservation programs for each State and community are at various degrees of mobilization and program implementation. Although the global economy is rebounding from the financial industry catastrophe, Palau's economy is recovering from Super Typhoons Bohpa and Haiyan with projected effects of decline in the tourism industry. The slight decline of tourism provides an opportunity for recovery and rejuvenation of the natural resources and the tourism impact on the environment. In Palau, the environment is its economy and its economy is its environment. The slight down turn in the tourism industry, although reducing the "green fee" and financial support for PAN Fund, provides for the necessary balances of tourism impacts on the environment and economic development with the safeguards and preservation of the environment with its natural resources and ecological biodiversity. Furthermore, PAN Fund has a predetermined budget for the following year based on the realized "green fee" for the current year. Therefore, PAN Fund and the PAN - the system-wide network - in partnership and collaboration will identify the key priorities to allocate and utilize the limited financial resources.

In addition, on risk mitigations and buffering economic downturns, PAN Fund's sustainable finance plan incorporates allocation of emergency funds, legal reserves and endowment accounts. Fundraising and diversification of funds are mitigations to build resilience and sustainable financial mechanisms. Furthermore, the strength and support from the Palau Congress and His Excellency President Tommy E. Remengesau, Jr.,³ a champion on environment and conservation causes, provides continued commitment for the MC to effectively conserve 30% of marine and 20% of terrestrial areas by the year 2020, impart and facilitate both the community and national will and collaboration for ecological biodiversity and natural resource conservation management programs in Palau. The international community's support and momentum generated by the MC and the United Nations CBD with generous fiscal and technical support from donor communities such as The David & Lucile Packard Foundation, TNC, CI, Global Environment Fund and other supporting partners and patrons lend for a positive outlook for PAN Fund and the people of Palau with programs for sustainable use of natural resources and conservation programs with cultural preservations for Palau's people today as well as the future of Palau and generations to come.

³ Statement by His Excellency Mr. Tommy Remengesau Jr., President of the Republic of Palau, to the 68th regular session of the United Nations General Assembly, New York: 25 September 2013.

CONCLUDING SUMMARY

The socialization with the transfer of technology and knowledge of the PAN and PAN Fund as a sustainable financial mechanism with the members of the PAN Institutional System continues to evolve to strengthen and synchronize partnership and collaborations between public and private sectors. PAN Fund is also mobilizing its effective management process for improved system-wide network management with the PAN system-wide design, utilizing Marxan for a cost effective approach towards a national, biological and ecological network to prioritize and strengthen the national system-wide network with scientific and social-economic approaches to support decisions for effective management of conservation programs in Palau.

PAN Fund is relatively new, yet is continuously evolving to keep strategies simple and concise with an objective to improve implementation to quickly respond and meet the needs of the PAN. Therefore, in the next fiscal year, the demand for investment and deposit policies for custodial credit risk will be given a priority to safeguard and mitigate risk exposure for PAN Fund's growing assets. PAN Fund will also continue to strive for effective and efficient measures and policies to be flexible and dynamic to quickly respond to changes and seize opportunities to sustainably support and finance the PAN. PAN Fund shall also continue to improve and adhere to controls and comply with its financial, managerial and operational procedures and policies to remain a prudent fiduciary and financial trustee for the PAN.

Management's Discussion and Analysis for the year ended September 30, 2012 is set forth in PAN Fund's report on the audit of financial statements, which is dated June 29, 2013. That Discussion and Analysis explains the major factors impacting the 2012 financial statements and can be viewed at the Office of the Public Auditor's website at www.palauopa.org.

CONTACTING PAN FUND'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of PAN Fund's finances and to demonstrate PAN Fund's accountability for monies entrusted with fiduciary care. Please visit www.palaupanfund.org for more information on Palau PAN programs. Inquiries and additional information on this report may be referred to Clarinda Ziegler, General Manager, The Protected Areas Network Fund, P.O. Box 6094, Koror, Republic of Palau 96940, or via the following: Phone: (680) 488-FUND (3863) | Fax: (680) 488-1314 | Email: cziegler@palaupanfund.org or info@palaupanfund.org.

PROTECTED AREAS NETWORK FUND

Statements of Net Position
September 30, 2013 and 2012

	<u>ASSETS</u>	
	<u>2013</u>	<u>2012</u>
Current assets:		
Cash	\$ 2,123,834	\$ 166,004
Receivable from Republic of Palau	468,196	1,869,701
Prepaid expenses	<u>3,022</u>	<u>-</u>
Total current assets	2,595,052	2,035,705
Fixed assets, net	<u>18,684</u>	<u>10,664</u>
	<u>\$ 2,613,736</u>	<u>\$ 2,046,369</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Accrued expenses	\$ 5,359	\$ -
Due to Micronesia Conservation Trust	<u>84,596</u>	<u>-</u>
Total liabilities	<u>89,955</u>	<u>-</u>
Commitment and contingency		
Net position:		
Invested in capital assets	18,684	10,664
Restricted	<u>2,505,097</u>	<u>2,035,705</u>
Total net position	<u>2,523,781</u>	<u>2,046,369</u>
	<u>\$ 2,613,736</u>	<u>\$ 2,046,369</u>

See accompanying notes to financial statements.

PROTECTED AREAS NETWORK FUND

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenues	\$ -	\$ -
Operating expenses:		
PAN site/states	813,460	811,762
PAN Institutional System	129,354	-
Micronesia Conservation Trust contribution	84,596	1,400,000
Salaries and wages	52,660	15,761
Competitive grant expense	44,226	-
Employee benefits	22,327	6,137
Professional fees	17,364	-
Travel and conferences	11,526	700
Professional development	11,482	-
Communications	9,558	1,497
Outreach/Awareness meetings	9,012	455
Rent	7,200	-
Utilities	3,739	-
Advertisements	3,063	1,004
Depreciation	2,436	-
Repairs and maintenance	783	2,810
Other	10,056	5,486
	<u>1,232,842</u>	<u>2,245,612</u>
Total operating expenses		
	<u>(1,232,842)</u>	<u>(2,245,612)</u>
Operating loss		
Nonoperating revenues:		
Transfer in from Republic of Palau	1,706,923	1,847,920
Other income	3,331	-
	<u>1,710,254</u>	<u>1,847,920</u>
Total nonoperating revenues		
Change in net position	477,412	(397,692)
Net position at beginning of year	<u>2,046,369</u>	<u>2,444,061</u>
Net position at end of year	<u>\$ 2,523,781</u>	<u>\$ 2,046,369</u>

See accompanying notes to financial statements.

PROTECTED AREAS NETWORK FUND

Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Micronesia Conservation Trust contribution	\$ -	\$ (1,400,000)
Cash payments to PAN sites/States and institutional system	(942,814)	(811,762)
Cash payments to suppliers for goods and services	(130,122)	(11,767)
Cash payments to employees for services	<u>(70,537)</u>	<u>(22,083)</u>
Net cash used for operating activities	<u>(1,143,473)</u>	<u>(2,245,612)</u>
Cash flows from noncapital financing activities:		
Transfer in from Republic of Palau	3,108,428	2,422,280
Other income	<u>3,331</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>3,111,759</u>	<u>2,422,280</u>
Cash flows from capital financing activities:		
Fixed asset acquisitions	<u>(10,456)</u>	<u>(10,664)</u>
Net cash used for capital financing activities	<u>(10,456)</u>	<u>(10,664)</u>
Net increase in cash	1,957,830	166,004
Cash at beginning of year	<u>166,004</u>	<u>-</u>
Cash at end of year	<u>\$ 2,123,834</u>	<u>\$ 166,004</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (1,232,842)	\$ (2,245,612)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	2,436	-
Increase in prepaid expenses	(3,022)	-
Increase in accrued expenses	5,359	-
Increase in due to Micronesia Conservation Trust	<u>84,596</u>	<u>-</u>
Net cash used for operating activities	<u>\$ (1,143,473)</u>	<u>\$ (2,245,612)</u>

See accompanying notes to financial statements.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(1) Organization

The Protected Areas Network Fund (PAN Fund), a component unit of the Republic of Palau (ROP), was formed on May 2, 2008, under the provisions of the Republic of Palau Public Law (RPPL) No. 7-42 for the purpose of administering and managing all funds received for the financial sustainability of the Protected Areas Network (the PAN) in Palau and for other related purposes. Portions of RPPL 7-42 were revised by RPPL 8-9 and RPPL 8-18. The Law created a registered non-profit corporation under the ROP corporate registry managed by a Board of Directors, consisting of seven voting members and the ROP Minister of Finance and the ROP Minister of Resources and Development, appointed in accordance with PAN Fund's Articles of Incorporation and approved by no less than two thirds of the Senate of the Olbiil Era Kelulau (ROP National Congress). PAN Fund's non-profit corporate charter was issued on November 2, 2010 by ROP and operations formally launched on March 24, 2012 upon receiving tourist and visitor environmental protection and arrival fee (Green Fee) monies from the ROP Ministry of Finance (MOF).

RPPL 7-42 authorized MOF to implement Green Fees to be used for the purpose of the operation of the PAN and to be deposited into an account at the National Treasury. The ROP Minister of Finance shall subsequently transfer the funds collected to PAN Fund. During the years ended September 30, 2013 and 2012, MOF collected \$1,691,923 and \$1,847,920, respectively, for this purpose, which PAN Fund recorded as transfers in from ROP Green Fees. PAN Fund recorded ROP Green Fees receivable of \$466,696 and \$1,869,701 as of September 30, 2013 and 2012, respectively. PAN Fund recorded \$15,000 and \$-0- as other transfers in from ROP for audit expense reimbursement, of which \$1,500 and \$-0- was receivable, as of and for the years ended September 30, 2013 and 2012, respectively. The receivables and transfers with ROP constitute all of PAN Fund's related party transactions, except for the grant described in note 4.

Funds administered, managed and invested by PAN Fund as the financial trustee corporation of the PAN shall include:

- Green Fees from ROP are to be used for general operations of the PAN. PAN Fund shall place five percent (5%) received from Green Fees and any unallocated funds remaining at the end of each fiscal year in the Micronesia Conservation Trust (MCT) Endowment, net investment revenues from which are available for PAN Fund's exclusive use at a later time, pursuant to guidelines of MCT. PAN Fund recorded MCT contributions of \$84,596 and \$1,400,000 for the years ended September 30, 2013 and 2012, respectively. PAN Fund considers its ensuing year budget to be an allocation of funds and therefore has not recorded a liability to MCT for any unallocated funds at September 30, 2013 and 2012;
- Donations, grants and other aid given to PAN Fund; and
- Income and other property derived from or attributed to the investment or application of property.

PAN Fund shall disburse all funding for:

- The implementation of PAN protected areas management, sustainable development and work plans for PAN sites based on performance, impact/outcome and appropriate management costs for the continuing sustainable operation of the PAN Fund;

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(1) Organization, Continued

- The undertaking of necessary research and educational activities substantially related to carrying out the provisions of RPPL No. 7-42; and
- The performance of any other functions that are necessary in order to carry out the purposes of RPPL No. 7-42 including the operation of the PAN Office. The PAN Office operates under the ROP Ministry of Natural Resources, Environment and Tourism. During the years ended September 30, 2013 and 2012, PAN Fund provided funding for activities specified in an annual work plan of PAN Office in the amounts of \$129,354 and \$-0-, respectively. Funding is recorded as PAN Institutional System expense in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

PAN Fund'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 PAN Fund conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. PAN Fund utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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

All 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 this fund are included in the statements of net position. Proprietary fund operating statements reflect increases and decreases in net total assets and utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Budget and Appropriation

In each year's national government fiscal year budget, the Olbiil Era Kelulau shall authorize and appropriate all money collected through the environmental protection arrival fee which shall be used for the sole purpose of the operation of the Protected Areas Network including authorization and appropriation of no more than ten percent (10%) of such amount to be allocated to PAN Fund for reasonable administrative costs of operation of PAN Fund. Budgetary financial statements are not considered to be a disclosure requirement by management.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

Cash

For purposes of the statements of net position and of cash flows, cash is defined as cash on hand and cash in checking account. As of September 30, 2013 and 2012, cash was \$2,123,834 and \$166,004, respectively, and the corresponding bank balances were \$2,172,105 and \$165,057, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2013 and 2012, bank deposits of \$416,365 and \$165,057 were FDIC insured, respectively. Collateralization of deposits is not required; therefore, uninsured deposits are exposed to custodial credit risk.

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 PAN Fund or its agent in PAN Fund'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 PAN Fund'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 PAN Fund'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, PAN Fund'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. PAN Fund does not have a deposit policy for custodial credit risk.

Fixed Assets

Fixed assets are stated at cost. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets. Current policy is to capitalize items in excess of \$100.

Retirement Plan

On August 8, 2013, PAN Fund withdrew from the Palau Civil Service Pension Trust Fund (the Fund) as the Fund considers PAN Fund to be a non-profit, non-governmental organization, and to be exempt from participation in the Fund.

Contribution refunds of \$5,405 were reimbursed by the Fund to PAN Fund on August 21, 2013, 50% of which were refunded to contributing employees. The net amount refunded is recorded as other income in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

Net Position

PAN Fund's net position is classified as follows:

- Invested in capital assets: capital assets, net of accumulated depreciation, plus construction or improvement of those assets.
- Restricted: net position subject to externally imposed stipulations that can be fulfilled by actions of PAN Fund pursuant to those stipulations or that expire by the passage of time. PAN Fund considers all assets, except investments in capital assets, to be restricted in accordance with the provisions of RPPL 7-42.
- Unrestricted: net position that are not subject to externally imposed stipulations. As PAN Fund considers all assets, except investments in capital assets to be restricted in accordance with the provisions of RPPL 7-42, PAN Fund does not have unrestricted net position at September 30, 2013 and 2012.

New Accounting Standards

During the year ended September 30, 2013, the PAN Fund implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement no. 62 superceded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PAN Fund.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of PAN Fund.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of PAN Fund.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 69 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of PAN Fund.

Reclassifications

Certain 2012 balances in the accompanying financial statements have been reclassified to conform to the 2013 presentation.

(3) Fixed Assets

Fixed assets of PAN Fund as of September 30, 2013 and 2012, are summarized below:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2012</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2013</u>
Furniture, fixtures and equipment	3 years	\$ 10,664	\$ 3,456	\$ -	\$ 14,120
Vehicle	3 years	<u>-</u>	<u>7,000</u>	<u>-</u>	<u>7,000</u>
		10,664	10,456	-	21,120
Less accumulated depreciation		<u>-</u>	<u>(2,436)</u>	<u>-</u>	<u>(2,436)</u>
		<u>\$ 10,664</u>	<u>\$ 8,020</u>	<u>\$ -</u>	<u>\$ 18,684</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2012</u>
Furniture, fixtures and equipment	3 years	\$ -	\$ 10,664	\$ -	\$ 10,664
Less accumulated depreciation		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
		<u>\$ -</u>	<u>\$ 10,664</u>	<u>\$ -</u>	<u>\$ 10,664</u>

(4) Contributions

The Micronesia Challenge (MC) is a commitment by the Chief Executives of the Republic of Palau, the Federated States of Micronesia (FSM), the Republic of the Marshall Islands, the U.S. Territory of Guam and the U.S. Commonwealth of the Northern Mariana Islands to effectively conserve at least 30% of the near-shore marine resources and 20% of the terrestrial resources across Micronesia by 2020.

PROTECTED AREAS NETWORK FUND

Notes to Financial Statements
September 30, 2013 and 2012

(4) Contributions, Continued

Micronesia Conservation Trust (MCT) is a non-profit trust corporation registered in the FSM whose mission is to support biodiversity conservation and related sustainable development of the people of Micronesia by providing long-term sustained funding opportunities, management and investment services. MCT holds MC assets in restricted endowment funds. During the year ended September 30, 2013 and 2012, PAN Fund contributed \$84,596 and \$1,400,000 to the MC endowment funds held by MCT. In previous years the Republic of Palau directly contributed \$500,000 to the MC endowment funds. MCT is responsible for disbursing all net investment revenues of the Palau portion of the MC endowment fund to PAN Fund in line with established guidelines. At September 30, 2013 and 2012, the Palau portion of MC endowment funds held by MCT was \$6,888,443 and \$6,270,470, respectively, which includes the above contributions and \$2,000,000 and \$1,684,848 from The Nature Conservancy and Global Environmental Facility, respectively, who have made contributions on Palau's behalf.

In accordance with RPPL 7-42, to support network wide activities, PAN Fund and PAN Office have entered into grants with the Palau International Coral Reef Center (PICRC) and the Palau Conservation Society (PCS) in the amounts of \$50,000 and \$54,931, respectively. The grant to PICRC, a component unit of ROP, is for strengthening and streamlining technical assistance on ecological monitoring for PAN States/Sites. The grant to PCS is for support with enabling legislation and capacity building for effective management of conservation programs for PAN States/Sites. During the years ended September 30, 2013 and 2012, \$44,226 and \$0-, respectively, were disbursed for these grants which is recorded as competitive grant expense in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

(5) Commitment

PAN Fund leases office space in Koror, Palau. Total future minimum lease payments under this lease for subsequent years ending September 30 are as follows:

Year ending September 30,

2014	\$ 12,600
2015	14,400
2016	14,400
2017	<u>3,600</u>
	\$ <u>45,000</u>

(6) Contingency

In accordance with PAN and PAN Fund legislation, PAN Fund is the only entity authorized to administer or disburse Green Fee funds. Before inception of PAN Fund on November 2, 2010 the PAN office was administered by the ROP Ministry of Natural Resources, Environment and Tourism. During the year ended September 30, 2011, ROP allocated \$57,147 against Green Fee collections to offset operational expenses of the PAN office. The \$57,147 represented 5% of Green Fees collected during the year ended September 30, 2010. An audit performed by the ROP Office of the Public Auditor determined that a portion of the allocation was contrary to PAN and PAN Fund legislation. PAN Fund has not recorded a receivable due to the uncertainty of the amount and collection.