

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

Years Ended September 30, 2019 and 2018

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Financial Statements

Year Ended September 30, 2019

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CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Directors
Belau Submarine Cable Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of net position of Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), as of September 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise BSCC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BSCC as of September 30, 2019 and 2018, 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 (MD&A) on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 8, 2020 on my consideration of the BSCC's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering BSCC's internal control over financial reporting and compliance.



Koror, Republic of Palau
July 8, 2020

BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

September 30, 2019

This section of Belau Submarine Cable Corporation's (BSCC) annual financial report presents management's analysis of its financial performance during the fiscal year ended September 30, 2019. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section. Responsibility for the completeness and fairness of this information rests with the Corporation. As management of the Belau Submarine Cable Corporation, a component unit of the Republic of Palau (ROP), we offer readers of the Corporation's financial statements this narrative overview and analysis of the financial activities of the Corporation for the fiscal year ended September 30, 2019. We encourage readers to consider the information presented in conjunction with the Corporation's financial statements, and accompanying notes to the financial statements.

The Belau Submarine Cable Corporation (BSCC) was established in 2015 to deliver state-of-the-art wholesale broadband internet services to the people of Palau. With the support of the Asian Development Bank (ADB), the project entails construction of a low latency submarine fiber optic cable linking Palau to a branching unit on the SEA-US submarine cable system. SEA-US provides connectivity between mainland USA (via Guam and Hawaii) and the Philippines and Indonesia. BSCCnet provides a link between Ngeremlengui in Palau and Piti in Guam, for onward interconnection to global networks.

Using This Annual Report

BSCC's financial statements are designed to emulate corporate presentation models whereby all Corporation activities are consolidated into one total. The focus of the Statements of Net Position is designed to be similar to bottom line results for the Corporation. This Statement combines and consolidates current financial resources (short-term spendable resources) with capital assets. The Statements of Revenues, Expenses, and Changes in Net Position focus on BSCC's start-up activities, which are supported by operating revenues after Ready for Service was declared on December 7, 2017. This approach is intended to summarize and simplify the user's analysis of cost of various BSCC services to the public.

BSCC Structure

BSCC was established in 2015 by RPPL9-47 (the BSCC Act), to progress a project initiated by the World Bank and Asian Development Bank (ADB) to provide international submarine fiber optic connectivity for the Republic of Palau (ROP). ADB remains as the sole financier. BSCC has provisionally applied for a license to operate a wholesale network in ROP in January 2018 in accordance with RPPL 10-17 of 2017 (the Telecoms Act). The sole shareholder in BSCC is the Minister of Finance. A Board of Directors is appointed by the ROP government.

BSCC was in its second year of operations during the fiscal year ended September 30, 2019. BSCC was established as a state-owned corporation to procure, own and manage a submarine fiber optic cable for the Republic of Palau.

BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

September 30, 2019

Overview of Financial Statements

The Financial Section of this report presents the Corporation's financial statements as two components: basic financial statements and notes to the financial statements.

Basic Financial Statements

The *Statement of Net Position* reflects the financial position of the Corporation as of September 30, 2019 and 2018. It shows the assets owned or controlled, deferred outflows of resources, related liabilities and other obligations, deferred inflows of resources, and the categories of net position. Net position is an accounting concept defined as total assets and deferred outflows less total liabilities and deferred inflows.

The *Statements of Revenues, Expenses, and Changes in Net Position* reflects the results of operations and other changes for the year ended September 30, 2019 and 2018. It shows revenues and expenses, both operating and non-operating, and reconciles the beginning net position amount to the ending net position amount, which is shown on the *Statements of Net Position* described above.

The *Statements of Cash Flows* reflect the inflows and outflows of cash for the year ended September 30, 2019 and 2018. It shows the cash activities by type and reconciles the beginning cash amount to the ending cash amount, which is shown on the *Statements of Net Position*, described above. In addition, this Statement reconciles cash flows from operating activities to operating profit on the *Statements of Revenues, Expenses, and Changes in Net Position*.

Notes to the Financial Statements

Various notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are found immediately following the financial statements to which they refer.

Current Status of Project

The initial scope of the project was completed well within the \$25M funding envelope. It included:

- An Indefeasible Right of Use (IRU) with Globe Telecom International (GTI) of Philippines for five 100 Gigabit per second wavelengths on the SEA-US cable that was Ready For Service (RFS) in July 2017. That is, at the time of writing this analysis, SEA-US is already completed and in operation. The IRU is a capacity ownership contract for the span from the Palau Branching Unit (BU) 3a to the Guam Telecom (GTA) Cable Landing Station in Guam.

BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

September 30, 2019

Current Status of Project, continued

- Construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, a Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths.
- Construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, approximately 210 km, including all CLS Submarine Line Terminating Equipment (SLTE), Power Feed Equipment (PFE), Network Protection Equipment (NPE) and network management systems and equipment, plus industry standard spares.

In FY 2018 the scope of the project was expanded so BSCC can fulfil its charter to provide equal access to its customers, since the CLS site, while the best available in Republic of Palau for a submarine cable landing, is somewhat remote from the main population centers. A proposal to extend the network with fiber along the roadside to an additional Customer Access Point (CAP) in Airai was approved by Asian Development Bank (ADB). This extension can be accommodated within the funding envelope. A design contract for the outside plant route has been completed by Globe Telecom of Philippines and a contract awarded to G&C Underground Services to construct the fiber link. This west-side fiber was well under way at the end of FY 2018/19, and at the time of writing both the east-side fiber and the Technical Center are under contract.

The original scope of the project was completed well under budget and ahead of schedule. The network was placed in service on December 7th 2017. Since a four-hour outage on May 23, 2018, network performance has been outstanding, achieving 100% availability most months.

BSCC's business model is shaped by the provisions of the BSCC Act. BSCC is a wholesale carrier, selling only to Retail Service Providers, at full economic cost (including financing cost). There is a single product, wholesale capacity between Palau and Guam. In such a capital-intensive commodity business, the key to maximizing the overall goals of improved services at significantly lower unit prices, is to ensure that the construction cost is managed effectively, with an uncompromising focus on quality. Expected cost to complete the full scope (including the network extension to Airai) is \$24M.

The network has been at 99.98% available (only one significant interruption, of 4 hours, as a result of a repair on the SEA-US trunk, in May 2018) since the start of the confidence trial on September 11, 2017.

Sales have exceeded expectations and are currently as of June 2020 at 7 Gbits/sec.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2019

Financial Statements for the Year Ended September 30, 2019 and 2018

Statements of Net Position

| Assets: | 2019 | 2018 |
|------------------------------------|---------------|---------------|
| Current assets | \$ 3,069,227 | \$ 1,379,259 |
| Capital assets, net | 17,643,067 | 17,842,122 |
| Other assets | 41,164 | 26,880 |
| Total assets | \$ 20,753,458 | \$ 19,248,261 |
| Liabilities and Net Position: | | |
| Current liabilities | \$ 144,240 | \$ - |
| Long-term debt | 19,370,542 | 18,733,998 |
| Net position | 1,238,676 | 514,263 |
| Total liabilities and net position | \$ 20,753,458 | \$ 514,263 |

Statements of Revenues and Expenses and Changes in Net Position

| | 2019 | 2018 |
|---------------------------------------|--------------|--------------|
| Operating revenues | \$ 2,972,950 | \$ 2,185,968 |
| Operating expenses | 1,602,120 | 1,796,886 |
| Operating income | 1,370,830 | 389,082 |
| Nonoperating revenues (expenses), net | (646,417) | 54 |
| Change in net position | 724,413 | 389,136 |
| Net position, beginning of year | 514,263 | 125,127 |
| Net position, end of year | \$ 1,238,676 | \$ 514,263 |

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2019

Financial Statements for the Year Ended September 30, 2019 and 2018, continued

Statements of Cash Flows

| | 2019 | 2018 |
|---|--------------|--------------|
| Net Cash flows from operating activities | \$ 1,932,064 | \$ 1,237,821 |
| Net cash used for capital and related financing activities | (686,612) | (43,347) |
| Net Cash flows from investing activities | 116 | 54 |
| Net change in cash | 1,245,568 | 1,194,528 |
| Cash, beginning of year | 1,319,259 | 124,731 |
| Cash, end of year | \$ 2,564,827 | \$ 1,319,259 |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 1,370,830 | \$ 389,082 |
| Adjustments to reconcile operating income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 875,678 | 935,619 |
| Increase in accounts receivable | (444,400) | - |
| Increase in other assets | (14,284) | (86,880) |
| Increase in current liabilities | 144,240 | - |
| | \$ 1,932,064 | \$ 1,237,821 |

The main movement in Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position items between FY 2019 and FY 2018 reflects the fact that BSCC moved to an operational focus. Accordingly, depreciation becomes a significant expense totaling approximately \$936,000 in FY 2019.

BSCC was funded by an injection of \$276,400 in cash and \$28,600 in kind by Republic of Palau on August 25, 2016. Additional financing was through back to back loans from Asian Development Bank (ADB) via Republic of Palau totaling US\$25,000,000 as part of the North Pacific Regional Connectivity Investment Project:

| | | |
|-------------------------------------|-----------------|--------------|
| 3346-PAL 7 th March 2016 | Ordinary Loan | \$16,470,000 |
| 3347-PAL 7 th March 2016 | Subsidiary Loan | \$8,530,000 |

BSCC has been servicing interest on debt from operational revenues since December 2018 (interest during construction was capitalized).

BELAU SUBMARINE CABLE CORPORATION

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Management's Discussion and Analysis

September 30, 2019

Economic Factors and Business Plan that will affect the Future

In most markets world-wide, capacity demand growth has proved remarkably impervious to fluctuations in overall economic activity. Given the significant tourist numbers in Palau relative to the resident population, a sustained downturn in tourist arrivals would have a negative impact on BSCC revenue growth. However, to the end FY 2018/19 there was steady growth in demand, consistent with global trends.

BSCC developed a Business Plan for fiscal years 2020 – 2024 which is briefly discussed below.

The Plan focuses on completing the network extension to Airai in 2020, the elimination of further potential single points of failure in BSCCnet, and the further refinement of operational processes. Forecast expenditure on general expenses for 2020 is \$887K, with another \$361K of specialist operational services. With interest expense of \$486K and \$600K added to reserves, total projected expenditure is \$2.333M. Furthermore, the BSCC Board had identified that the single point of failure represented by the BSCC submarine network presented a serious risk to Palau's economy and society, given the extraordinary growth of capacity requirements and the increasing reliance of all aspects of business, education, medicine, entertainment and social activity on high speed connectivity. Accordingly, throughout FY 2018/19, BSCC was actively gathering support for a Second Cable resilience strategy.

Business Objectives

The primary business objective of BSCC is to

Provide ICT Service Providers in Palau with equal access to high quality wholesale capacity at the lowest pricing commensurate with full cost recovery.

The focus of this Business Plan is the consolidation of the gains flowing from the newly constructed submarine link providing international connectivity to ROP. The business issues addressed by the Plan are:

- a) Complete CAP-A Extension.
- b) Develop second cable financing solution.
- c) Work with other parties in the ROP telecommunications market to ensure effective market performance.
- d) Work with relevant authorities to ensure effective disaster planning for international connectivity.
- e) Develop BSCC capability, including staff recruitment and network resilience.
- f) Define key operational arrangements including ongoing management, marine maintenance, landing party agreements and Network Operations Center (NOC).
- g) Establish the expenditures and revenues associated with the development and operations of BSCCnet.
- h) Set out the financing arrangements to underpin BSCC and its projects.
- i) Analyze risks associated with the company's activities.

BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

September 30, 2019

Strategic Framework

BSCC's price positioning is defined by the BSCC Act. Accordingly, BSCC will operate pricing regimes that support servicing and repayment of debt and business costs, rather than maximize profits.

BSCC is a wholesale supplier in the ROP telecommunication market. This enables the lowest possible cost structure, as BSCC supplies raw capacity to Retail Service Providers (RSPs), rather than telecommunications services to end-user customers, avoiding the need to invest in complex product support and billing systems, sales and marketing capability and customer support systems. By positioning as a wholesaler, BSCC also avoids the difficult position of having to compete with its own customers, who are much better resourced to develop, supply and support telecommunications services in the retail market.

BSCC offers the same capacity products, pricing, payment options and terms and conditions to all eligible customers (i.e. licensed RSPs).

Because BSCCnet will be relatively small in terms of capacity in service compared to other intercontinental submarine networks, and is likely to have relatively few customers (perhaps no more than four in the medium term), its operational needs will not justify extensive fulltime roles. Accordingly, BSCC outsources the majority of its business functions in network operations and management, finance, IT and legal.

Our Network

The international route is a repeatered connection from Ngeremlengui Cable Landing Station (CLS) to a Branching Unit on the SEA-US main cable, with onward transport on SEA-US to the GTA CLS in Guam.

BSCC plans to construct a network extension to the airport site and establish a new Capacity Access Point there. This work is now contracted and will be completed within the \$25M ADB loan available.

Our Technology

The network technology deployed for BSCCnet is identical to that used for the main SEA-US cable, based on the latest available commercial technology, utilizing 100 Gbit/sec wavelengths, supplied by NEC.

BSCC has currently lit one of five 100 Gbit/sec wavelengths over which it holds an IRU with Globe Telecom of Philippines. The link between the GTA CLS and CAP-G, provided by GTA of Guam, is currently configured at 10 Gbit/sec. This potential bottleneck and single point of failure will be addressed by provision of a diverse link in late 2020.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2019

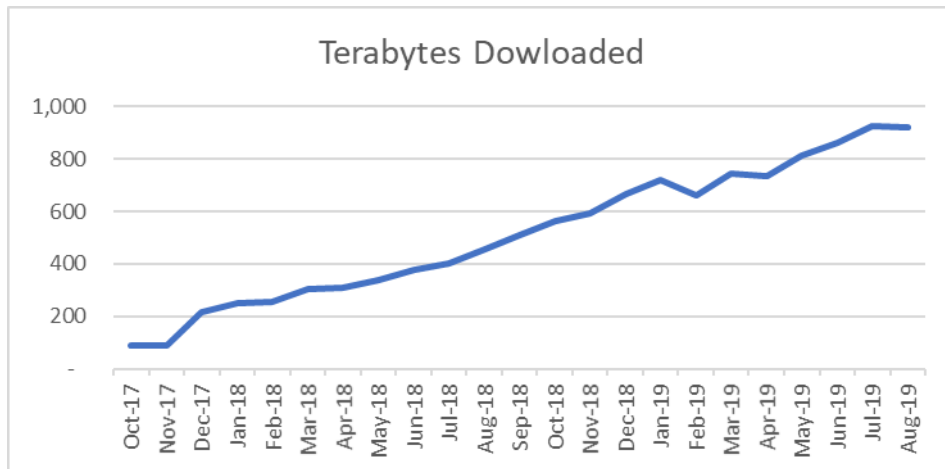
Our Technology, continued

The core submarine network is augmented by twin Ciena network routers in both CAP-N and CAP-G to facilitate resilient and flexible management of customer access. The same standard interface will be available to BSCC's RSP customers at CAP-A. BSCC can support up to 10 Gbit/sec on current network configuration.

Marketing Capacity

Pre-BSCCnet, total satellite capacity use for ROP was estimated at 400 Mbps. There was an immediate increase to 1,000 Mbps by March 2018. In the six months after Ready for Service, by the end of FY 2017/18, BSCCnet traffic doubled again to 2,000 Mbps. By the end of FY 2018/19, it doubled again to 4,000 Mbps.

Total download volumes have grown commensurately as depicted below.



Market and Regulatory

The Palau telecommunications market is competitive, regulated by the Bureau of Communications established under RPPL 10-17 of 2017 (the Telecoms Act). Regulation remains in its infancy, with significant uncertainty. A Regulator was appointed in late 2019.

The ROP telecommunications market is still largely dominated by the incumbent provider, Palau National Communications Corporation. The main competitor is Palau Telecom, which has operated a Wi-Fi network and is expanding into mobile and possibly fixed line customer access. Palau Wi-Fi continues to operate a small operation focused on tourist hotels. The Telecoms Act (2017) provides for a moratorium on new market entrants until January 1, 2020, with a further extension of three years, to January 2023.

BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

September 30, 2019

Market and Regulatory, continued

The Republic of Palau is the world's first all-IP network. RSPs agreed to establish an open interconnection regime in August 2018. BSCC supports minimum regulatory complexity consistent with orderly allocation of public resources such as spectrum numbering.

Post Balance Day Events

Since September 2019, BSCC had made considerable progress in its quest to finance a second cable connection. The targeted system for a Branching Unit (BU) connection was identified, preliminary costings undertaken and debt financing arranged through assistance from:

- Australia Infrastructure Financing Facility for the Pacific (AIFFP)
- Japan Bank for International Cooperation (JBIC)
- Sumitomo Mitsui Banking Corporation (SMBC)

However, on March 23, 2020 the project was suspended. The financing plan would have expended all of BSCC available cash, which was regarded as imprudent given the likely impacts of the global pandemic and the need to conserve cash reserves to meet exigencies.

BSCC customers were already feeling the impact of zero tourist sales, even while traffic volumes held steady. BSCC expects its cash receipts to be impacted by approximately 30% through the balance of FY2019/20 and FY2020/21.

Despite this, the Second Cable project international supporters were able to provide grant and debt support for a fall-back solution, requiring just \$1.1M of BSCC equity, to complete the marine survey and to acquire rights to a BU and future capacity on the target network. Total cost is \$3.8M.

The possibility of completing the entire Second Cable connection remains open, with the US stepping up with significant grant funds on offer, and the possibility of further assistance. With the support of Republic of Palau, and the US, Japan and Australia governments, the project is once again moving forward.

Requests for Information

This report is intended to provide a summary of the financial condition of Belau Submarine Cable Corporation. Questions or requests for additional information should be addressed to:

Robin Russell
Chief Executive Officer
P.O. Box 10253
Koror, Palau 96940

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Net Position
September 30, 2019 and 2018

| <u>ASSETS</u> | <u>2019</u> | <u>2018</u> |
|-------------------------------------|----------------------|----------------------|
| Current assets: | | |
| Cash | \$ 2,564,827 | \$ 1,319,259 |
| Accounts receivable | <u>504,400</u> | <u>60,000</u> |
| Total current assets | <u>3,069,227</u> | <u>1,379,259</u> |
| Capital Assets: | | |
| Depreciable capital asset, net | 11,487,633 | 11,420,027 |
| Indefeasible right of use, net | 6,155,434 | 6,422,095 |
| Other assets | <u>41,164</u> | <u>26,880</u> |
| Total capital assets, net | <u>17,684,231</u> | <u>17,869,002</u> |
| Total assets | <u>\$ 20,753,458</u> | <u>\$ 19,248,261</u> |
| <u>LIABILITIES AND NET POSITION</u> | | |
| Current Liabilities: | | |
| Accrued expenses | \$ 144,240 | \$ - |
| Non-current Liabilities: | | |
| Long-term debt | <u>19,370,542</u> | <u>18,733,998</u> |
| | <u>19,514,782</u> | <u>18,733,998</u> |
| Commitments | | |
| Net Position: | | |
| Net investments in capital assets | (1,727,475) | (891,876) |
| Unrestricted | <u>2,966,151</u> | <u>1,406,139</u> |
| Total net position | <u>1,238,676</u> | <u>514,263</u> |
| Total liabilities and net position | <u>\$ 20,753,458</u> | <u>\$ 19,248,261</u> |

See accompanying notes to financial statements.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Revenues and Expenses and Changes in Net Position
Years Ended September 30, 2019 and 2018

| | 2019 | 2018 |
|--|--------------|--------------|
| Revenue | \$ 2,972,950 | \$ 2,185,968 |
| Operating expenses: | | |
| Depreciation and amortization | 875,678 | 935,619 |
| Salaries and wages | 210,973 | 228,814 |
| Customer service center support | 114,000 | 76,000 |
| Travel | 54,279 | 41,590 |
| Marine maintenance | 46,592 | 39,864 |
| Capacity purchase | 46,170 | 43,512 |
| Professional fees | 35,650 | 229,142 |
| Network operating center | 31,000 | 18,500 |
| Communications | 26,438 | 15,991 |
| Insurance | 22,495 | 22,495 |
| Bank service charges | 22,238 | 1,324 |
| Utilities | 18,711 | 19,792 |
| Rent | 17,898 | 20,753 |
| Meals and entertainment | 6,835 | 9,335 |
| Advertising | 3,544 | 19,490 |
| Director fees | 2,500 | 38,244 |
| Office supplies | 1,548 | 12,773 |
| Miscellaneous | 65,571 | 23,648 |
| Total operating expenses | 1,602,120 | 1,796,886 |
| Operating income | 1,370,830 | 389,082 |
| Nonoperating revenues (expense): | | |
| Interest expense | (646,533) | - |
| Interest income | 116 | 54 |
| Total nonoperating revenues (expense), net | (646,417) | 54 |
| Change in net position | 724,413 | 389,136 |
| Net position, beginning of year | 514,263 | 125,127 |
| Net position, end of year | \$ 1,238,676 | \$ 514,263 |

See accompanying notes to financial statements.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Cash Flows
Years Ended September 30, 2019 and 2018

| | <u>2019</u> | <u>2018</u> |
|---|---------------------|---------------------|
| Cash flows from operating activities: | | |
| Cash received from customers for services | \$ 2,514,266 | \$ 2,099,088 |
| Cash paid to suppliers for goods and services | <u>(582,202)</u> | <u>(861,267)</u> |
| | <u>1,932,064</u> | <u>1,237,821</u> |
| Cash flows from capital and related financing activities: | | |
| Acquisition of capital assets | (676,623) | (2,302,237) |
| Acquisition of indefeasible right of use | - | (2,658,935) |
| Proceeds from long-term debt | 636,544 | 4,917,825 |
| Interest paid on long-term debt | <u>(646,533)</u> | <u>-</u> |
| Net cash provided by capital and related financing activities | <u>(686,612)</u> | <u>(43,347)</u> |
| Cash flows from investing activities: | | |
| Interest received on cash in bank | <u>116</u> | <u>54</u> |
| Net change in cash | 1,245,568 | 1,194,528 |
| Cash, beginning of year | <u>1,319,259</u> | <u>124,731</u> |
| Cash, end of year | <u>\$ 2,564,827</u> | <u>\$ 1,319,259</u> |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 1,370,830 | \$ 389,082 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation and amortization | 875,678 | 935,619 |
| Increase in accounts receivable | (444,400) | (60,000) |
| Increase in other assets | (14,284) | (26,880) |
| Increase in accrued expenses | <u>144,240</u> | <u>-</u> |
| | <u>\$ 1,932,064</u> | <u>\$ 1,237,821</u> |

See accompanying notes to financial statements.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies

Organization

Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), was created on September 15, 2015, under the provisions of Republic of Palau Public Law (RPPL) 9-47 and approved and signed in by the President of the Republic of Palau on September 21, 2015. (as amended, the “Incorporation Act”). In accordance with the Incorporation Act, the initial shareholders of BSCC is the Government of the Republic of Palau. The law created a wholly-owned government corporation governed by a Board of Directors comprising five (5) members appointed by the President of the ROP, with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress). The Board members serve terms of four (4) years and may reappointed by the President with the advice and consent of the ROP National Congress.

The primary purpose of BSCC is to procure, own and manage a fiber optic cable on behalf of the ROP government.

Basis of Accounting

The accounting policies of BSCC conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. BSSC 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. The Corporation utilizes the accrual basis of accounting.

The financial statements of BSCC have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental entities. BSCC implemented Government Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement identifies and -consolidates accounting and financial reporting provisions that apply to state and local governments.

BSCC implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Government as amended by GASB Statement No. 37, Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*, establish standards external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three categories:

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies, Continued

Net investment in capital assets:

Capital assets net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction or improvements of those assets.

Restricted:

Net position whose use by the Corporation is subject to externally imposed stipulations that can be fulfilled by actions of the Corporation pursuant to those stipulations or that expire with the passage of time. The Corporation has no restricted net position at September 30, 2019 and 2018.

Unrestricted:

Unrestricted net position is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Cash

For the purposes of the Statement of Net Assets and Statement of Cash Flows, BSCC considers cash to be cash on hand plus cash in checking and savings accounts. All of BSCC's cash deposits are with a federally insured bank, \$250,000 of which is subject to coverage by federal insurance and is within insurable limits as of September 30, 2019 and 2018.

Accounts Receivable

Accounts receivable are due from a ROP governmental entity and businesses all located with the Republic of Palau and are interest free and uncollateralized.

Accounts receivable are stated at the amount management expects to collect on outstanding balances. Management provides for probable uncollectible amounts to through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still uncollectible after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Management believes that it accounts receivable are collectible, therefore a valuation was not recorded at September 30, 2019 and 2018.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies, Continued

Property, Plant and Equipment

Property, plant and equipment are stated at cost. BSSC capitalizes buildings, land improvements and equipment that have a cost of \$200 or more and an estimated useful life of at least five years. The cost of maintenance and repairs is charged to expense. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets which range from 3 to 40 years. Depreciation expense was \$609,017 and \$691,179 for the years ended September 30, 2019 and 2018, respectively.

Capital Asset Under Construction

The capital asset under construction represents the cost incurred for the submarine fiber optic spur to-date totaling \$9,406,768 as of September 30, 2017 and also includes related capitalized interest totaling \$157,973. This includes the construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths. It also includes the construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, including all CLS Submarine Line Terminating Equipment, Power Feed Equipment, Network Protection Equipment and network management systems and equipment, plus industry standard spares. Construction was completed as of September 30, 2018.

Indefeasible Right of Use

BSSC has capitalized the cost of acquisition of the exclusive right to use a specified amount of fiber capacity for a period of time, which is amortized over 25 years, the length of the term of the capacity agreement on the straight-line method.

Valuation of Long-lived Assets

The Corporation, using its best estimates based on reasonable and supportable assumptions and projections, reviews assets for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable. Impaired assets are reported at the lower of cost or fair value. At September 30, 2019 and 2018, no assets had been written down.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Summary of Significant Accounting Policies, Continued

Net Position

Net position represents the residual interest in BSCC's assets after liabilities are deducted. Net investments in capital assets include capital assets reduced by outstanding debt. Unrestricted net position is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Pensions

BSCC does not participate or contribute 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. BSCC is exempt from contributing to the ROP Pension plan pursuant to RPPL 9-47 and it was not included in the most recent actuarial study conducted for the ROP Civil Service Trust Fund. The Fund issues a stand-alone financial report which is available at its office site.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

Revenues

Revenue from capacity use agreements is recognized when earned in accordance with applicable terms.

Non-operating Revenues and Expenses

Non-operating revenues and expenses result from investing and financial activities, including operating and capital grants from governmental entities and interest paid on long-term debt. Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as interest income, and other revenue sources that are defined as non-operating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Summary of Significant Accounting Policies, Continued

Income Taxes

ROP does not impose corporate income taxes. In lieu of income taxes, all businesses are required to pay a business Gross Revenue Tax (GRT) on essentially all revenue received. The tax rate is 4% and is paid on a quarterly basis. BSCC is exempt from GRT.

New Accounting Standards

During the year ended September 30, 2019, the Corporation implemented the following GASB pronouncements:

- In November 2016 GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance of this Statement. GASB Statement No. 83 will be effective for the fiscal year ending September 30, 2019. The implementation of this Statement did not have a material effect on the BSCC's financial statements.
- In March 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The Statement's objective is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2019.
- In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. GASB Statement No. 89 will be effective for fiscal year ending September 30, 2021.

The implementation of these Statements did not have a material effect on the BSCC's financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This Statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. GASB Statement No. 84 will be effective for reporting periods after December 15, 2018. Management does not believe that the implementation of this Statement will have a material impact on Corporation's financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financing of the right of use an underlying asset. The provisions of Statement No. 87 are effective for fiscal years ending September 30, 2021. Management has yet to determine if the implementation of the Statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interest – an Amendment of GASB Statements No. 14 and Nor. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. The provisions in this Statement are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In May 2019, GASB issued Statement No. 91 *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. The provision of Statement No. 91 is effective for fiscal years beginning after December 15, 2021. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In April 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates (IBOR)*. The primary objective of this Statement is to address those and other accounting and financial reporting implications of the replacement of IBOR. GASB Statement No. 93 will be effective for fiscal year ending September 30, 2021. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(2) 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. This statement 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 BSCC or its agent in the BSCC'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 the BSCC'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 BSCC's name and noncollateralized 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, BSCC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. BSCC does not have an investment and deposit policy for custodial credit risk.

For credit risk in the case of deposits, there is the risk that in the event of a bank failure, BSCC's deposits may not be returned to it. As of September 30, 2019 and 2018, the carrying amount of BSCC's total cash in checking and savings was \$1,319,259 and \$124,731 with a corresponding bank balance of \$1,299,138 and \$124,731, respectively. From these deposits, \$250,000 at September 30, 2019 and 2018 was subject to coverage by FDIC. BSCC does not require collateralization of bank accounts, and therefore, amounts in excess of insurable limits are uncollateralized and are subject to custodial credit risk.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(2) Deposits and investments, Continued

Investments

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 | Investments that are insured or registered, or securities held by BSCC or its agent in BSCC's name; |
| Category 2 | Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the BSCC's name; or |
| Category 3 | Investments that are uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in BSCC's name. |

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 and provided for disclosure requirements addressing other common risks of 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.

As of September 30, 2018, and 2017, BSCC did not have investments subject to GASB Statement No. 40.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(3) Capital Assets

Capital asset activity for the years ended September 30, 2019 and 2018 are as follows:

| | Estimated Useful Lives | Balance 9/30/2018 | Additions | Transfers In (Out) | Balance 09/30/2019 |
|----------------------------------|---------------------------|----------------------|------------------|-----------------------|-----------------------|
| Buildings and Improvements | 5 - 25 yrs | \$ 679,708 | \$ 1,274 | \$ - | \$ 680,982 |
| Plant and Equipment | 5 - 10 yrs | 151,790 | 616,918 | - | 768,708 |
| Submarine Terminal Equipment | 20 - 25 yrs | 3,336,009 | - | - | 3,336,009 |
| Submarine Cable | 20 - 25 yrs | 7,376,028 | - | - | 7,376,028 |
| Support Equipment | 3 - 5 yrs | 552,523 | - | - | 552,523 |
| Vehicles | 3 - 5 yrs | 15,148 | - | - | 15,148 |
| | | 12,111,206 | 618,192 | - | 12,729,398 |
| Accumulated depreciation | | (691,179) | (609,017) | - | (1,300,196) |
| | | 11,420,027 | 9,175 | - | 11,429,202 |
| Capital asset under construction | | - | 58,431 | - | 58,431 |
| Net capital assets | | <u>\$ 11,420,027</u> | <u>\$ 67,606</u> | <u>\$ -</u> | <u>\$ 11,487,633</u> |

| | Estimated Useful Lives | Balance 9/30/2017 | Additions | Transfers In (Out) | Balance 09/30/2018 |
|----------------------------------|---------------------------|----------------------|---------------------|-----------------------|-----------------------|
| Buildings and Improvements | 5 - 25 yrs | \$ - | \$ 284,907 | \$ 394,801 | \$ 679,708 |
| Plant and Equipment | 5 - 10 yrs | - | 151,790 | - | 151,790 |
| Submarine Terminal Equipment | 20 - 25 yrs | - | - | 3,336,009 | 3,336,009 |
| Submarine Cable | 20 - 25 yrs | - | 1,857,792 | 5,518,236 | 7,376,028 |
| Support Equipment | 3 - 5 yrs | - | - | 552,523 | 552,523 |
| Vehicles | 3 - 5 yrs | - | 7,748 | 7,400 | 15,148 |
| Depreciable capital assets | | 402,201 | - | (402,201) | - |
| | | 402,201 | 2,302,237 | 9,406,768 | 12,111,206 |
| Accumulated depreciation | | - | (691,179) | - | (691,179) |
| | | 402,201 | 1,611,058 | 9,406,768 | 11,420,027 |
| Capital asset under construction | | 9,406,768 | - | (9,406,768) | - |
| Net capital assets | | <u>\$ 9,808,969</u> | <u>\$ 1,611,058</u> | <u>\$ -</u> | <u>\$ 11,420,027</u> |

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(4) Indefeasible Right of Use (IRU) Agreement

In February 2016, BSCC and a third party IRU provider entered into an agreement for the acquisition of the executive right to use the optical wavelength channels in the IRU provider's fiber between the Guam Cable Landing Station and the West Subsystem near the coast of Palau (the "Branching Unit"), as required for BSCC's use of capacity in such optical wavelength channels to transmit telecommunication traffic (the "Purchased Waves"); as well as the exclusive right to connect the submarine fiber optic cable spur to the Branching Unit and to connect to the optical add-drop multiplexer inside the Branching Unit.

The agreement is effective for 25 years starting on the date BSSC issues its notice of acceptance to the IRU provider of the first activated Purchase Wave's conformity to all applicable requirements (the "IRU RFS date").

Total purchase price is \$6.7 million and was fully paid as of September 30, 2018. The amortization of the IRU commenced in November 2017, which was the IRU RFS date. The Corporation recognized amortization expense in the amount of \$266,661 and \$244,440 for the years ended September 30, 2019 and 2018, respectively.

(5) Long-Term Debt

During March 2016, BSCC and Asian Development Bank (ADB) entered into an agreement for the North Pacific Regional Connectivity Investment Project (Project Agreement), which provides for the establishment of a submarine cable connection from Palau to the submarine cable system owned by the SEA-US Consortium that connects to the international cable hub in Guam (the "Project").

Under the Project Agreement, ADB has agreed to:

- a) Lend ROP \$16,470,000 on the condition that the proceeds of the loan be made available to BSCC, which agrees to undertake certain obligations towards ADB under the agreement ("Ordinary Operations Loan Agreement"), and
- b) Lend ROP, in various currencies, equivalent to Special Drawing Rights (SDR 6,032,000) or \$8,530,000 on the condition that the proceeds of the loan be made available to BSCC, which agrees to undertake certain obligations towards ADB under the agreement ("Special Operations Loan Agreement").

Also, in March 2016, ROP executed a subsidiary loan agreement with BSCC to re-lend the amounts disbursed by ADB to ROP under the same terms and conditions provided in the Ordinary and Special Operations Loan Agreements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(5) Long-Term Liabilities, Continued

Long-term debt at September 30, 2019 and 2018 is as follows:

| | 2019 | 2018 |
|---|----------------------|----------------------|
| Loan payable under the Ordinary Operations Loan Agreement, guaranteed by the ROP government, with a 20-year term after the grace period ends on June 1, 2021, with the first principal repayment becomes due, interest at LIBOR plus 0.50% per annum and payable every June 1 and December 1. Principal is to be repaid at 2.5% of the total principal amount outstanding on each payment date. | \$ 12,764,697 | \$ 12,358,889 |
| Loan payable under the Special Operations Loan Agreement, guaranteed by the ROP government, with a 20-year term after the grace period ends on June 1, 2021, with the first principal repayment of \$213,250 becomes due, interest at 2% per annum and payable every June 1 and December 1. | <u>6,605,845</u> | <u>6,375,109</u> |
| | <u>\$ 19,370,542</u> | <u>\$ 18,733,998</u> |

As of September 30, 2019, amounts available under the Ordinary and Special Operations Loan Agreements that may be drawn in subsequent years approximate \$3.7 million and \$1.9 million, respectively. Given the uncertainty in predicting when additional drawdowns will occur, presentation of future principal and interest amortization is not possible at this time.

As of September 30, 2019, there was no current portion due on the long-term debt.

For the years ended December 31, 2019 and 2018, interest expense on the aforementioned long-term debt was \$646,533 and \$0, respectively.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(5) Long-Term Liabilities, Continued

Long-term liabilities of BSCC consist solely of notes payable. The changes in in long-term liabilities for the years ended September 30, 2019 and 2018 are as follows:

| | Outstanding October 1, 2018 | Increases | Decreases | Outstanding September 30, 2019 | Current | Noncurrent |
|---------------|-----------------------------------|---------------------|-------------|--------------------------------------|-------------|----------------------|
| Notes Payable | \$ 18,733,998 | \$ 636,544 | - | \$ 19,370,542 | - | \$ 19,370,542 |
| | <u>\$ 18,733,998</u> | <u>\$ 636,544</u> | <u>\$ -</u> | <u>\$ 19,370,542</u> | <u>\$ -</u> | <u>\$ 19,370,542</u> |
| | | | | | | |
| | Outstanding October 1, 2017 | Increases | Decreases | Outstanding September 30, 2018 | Current | Noncurrent |
| Notes Payable | \$ 13,816,173 | \$ 4,917,825 | - | \$ 18,733,998 | - | \$ 18,733,998 |
| | <u>\$ 13,816,173</u> | <u>\$ 4,917,825</u> | <u>\$ -</u> | <u>\$ 18,733,998</u> | <u>\$ -</u> | <u>\$ 18,733,998</u> |

(6) Capacity Use, Lease and Other Commitments

Commencing December 2017, BSCC leases telecommunications capacity with various customers located in the Republic of Palau under a three-year capacity use agreement with total quarterly customer payments in the amount of \$670,500.

Future minimum receipts under the capacity lease agreements are as follows:

| Year ending September 30, | |
|---------------------------|---------------------|
| 2020 | \$ 2,896,800 |
| 2021 | <u>724,200</u> |
| | <u>\$ 3,621,000</u> |

Effective December 2017, BSCC leases commercial space under a five-year lease agreement at an annual rate of \$3,498, payable in advance.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2019 and 2018

(6) Capacity Use, Lease and Other Commitments, Continued

Additionally, BSCC has entered into various third-party support agreements with terms ranging from 12 months to 7 years.

Future commitments resulting from the service agreements are as follows:

| <u>Year ending September 30,</u> | |
|----------------------------------|-------------------|
| 2020 | \$ 180,500 |
| 2021 | 180,500 |
| 2022 | 180,500 |
| 2023 | 161,700 |
| 2024 | 155,500 |
| Thereafter | <u>48,400</u> |
| | <u>\$ 907,100</u> |

During October 2017, BSCC executed a capacity service agreement with a third-party provider for a period of 7 years at an estimated charge of \$4,800 per month.

During December 2018, BSCC engaged a third-party to construct a fiber optic cable extension linking the Cable Landing Station at the Ngeremlengui Cable Landing Station Customer Access Point (CAP-N) to a new Capacity Access Point in Airai. The construction, which has a contract value of \$1.5 million, will be funded by the existing loan facilities with ADB. The connection, which will provide a medium to long-term solution for customer access, aims for greater network capacity to support anticipated future demand. Construction costs incurred totaled \$58,431 as of September 30, 2019.

(7) Fair Value of Financial Instruments

BSCC's financial instruments are cash, accrued expenses and long-term debt. The recorded value for cash approximates its fair value based on its short-term nature. The recorded value the note payable approximates its fair value, as interest approximates market rates. The fair values of BSCC's long-term debt is determined using quoted market prices for those securities or similar financial instruments.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2019 and 2018

(8) Risk Management

BSCC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters, employee health, dental and accident benefits. BSCC has elected to purchase commercial insurance coverage for claims arising from such matters.

BSCC is self-insured for underwater cables.

Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported during the year ended September 30, 2019 and 2018.

(9) Concentration of Risk

The Company leases its telecommunications capacity and derives its revenues from three customers in the Republic of Palau. The leases are under three-year capacity use agreements with extension options. The Company is potentially subject to concentrations of credit risk in its accounts receivable and revenues. Of the Company's three customers, one major customer, which is a government entity, accounted for approximately \$304,000 or 67% of total accounts receivable and approximately \$2 million or 69% of revenues for the year ended September 30, 2019. Generally, the Company does not require collateral or other securities to support its accounts receivable. The Company expects to maintain this relationship with the customer. Although the Company is directly affected by the financial condition of its customers, management does not believe significant credit risks exist at December 31, 2019.

(10) Subsequent Events

In preparing the accompanying financial statements and these footnotes, management has evaluated subsequent events through July 8, 2020, which is the date the financial statements were available to be issued. There were no such events requiring disclosure or adjustment to the accompanying financial statements.

BELAU SUBMARINE CABLE CORPORATION
(A Component Unit of the Republic of Palau)

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

Years Ended September 30, 2019 and 2018



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Belau Submarine Cable Corporation:

We have audited, in accordance with the 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, the financial statements of Belau Submarine Cable Corporation (the Corporation), which comprise the statement of net position as of September 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and the statement of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 8, 2020.

Internal Control over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Belau Submarine Cable Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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



Koror, Republic of Palau
July 8, 2020