

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

**INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS**

Years Ended September 30, 2011 and 2010

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

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SEPTEMBER 30, 2011 and 2010

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Palau District Housing Authority

I have audited the accompanying combined financial statements of Palau District Housing Authority (the Authority), a component unit of the Republic of Palau, as set forth in Section I of the foregoing Table of Contents, as of September 30, 2011 and 2010, and for the years then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audits. The prior year summarized comparative information has been derived from the Authority's 2010 financial statements and, in my report dated January 25, 2011, I expressed an unqualified opinion on those financial statements.

I conducted my 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 I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, I do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Palau District Housing Authority as of September 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated January 13, 2012 on my consideration of Palau District Housing Authority's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, grants and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 15 and 41 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. I 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 I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Palau District Housing Authority's financial statements as a whole. The statistical section is presented for purposes of additional analysis and is not a required part of the financial statements. The statistical section is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The statistical section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, I do not express an opinion or provide any assurance on them.


Koror, Republic of Palau
January 13, 2012

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2011

As management of the Palau District Housing Authority (the Authority), a component unit of the Republic of Palau (ROP), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended September 30, 2011. We encourage readers to consider the information presented in conjunction with the Authority's financial statements, and accompanying notes to the financial statements on pages 16 through 40.

Financial Highlights

- The assets of the Authority exceeded its liabilities at September 30, 2011 and 2010 by \$2,804,017 and \$2,807,879, respectively. The Authority's net assets (assets less liabilities) decreased by \$3,862 from the previous year. The decrease in net assets is a result of expenses incurred exceeding revenues earned.
- The Authority's cash and cash equivalents at September 30, 2011 and 2010 was \$1,014,213 and \$971,330, respectively, representing an increase of \$42,883 due primarily to continuous collection of notes receivable and decreased loan disbursements. In FY2011, there were only five (5) new loan applications approved.
- The Authority had net operating revenues of \$160,504 and \$169,703 and operating expenses of \$165,204 and \$127,405 for the years ended September 30, 2011 and 2010, respectively. The decrease of \$9,199 in net operating revenues is attributable mainly to lower interest income earned on loans (\$11,645) and decreased Section 8 rental income (\$7,550) due to the demolition of the Section 8 housing units in the middle of the year. Operating expenses, on the other hand, increased by \$37,799 due primarily to the \$22,631 provision for possible uncollectibility of some identified rental receivables and the \$18,787 cost of Section 8 housing demolition.

Overview of the Financial Statements

The Management Discussion and Analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of two components: 1) authority-wide financial statements; and 2) notes to the financial statements.

AUTHORITY-WIDE FINANCIAL STATEMENTS

The authority-wide financial statements are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2011

Overview of the Financial Statements, Continued

AUTHORITY-WIDE FINANCIAL STATEMENTS, Continued

The *Combined Statement of Net Assets* presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The *Combined Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this Statement for some items that will only result in cash flows in future fiscal periods (e.g., depreciation and earned but unused vacation leave).

The *Combined Statement of Cash Flows* provides information about the Authority's cash receipts and cash payments during the reporting period. This Statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities.

The authority-wide financial statements report on the function of the Authority that is principally supported by intergovernmental revenues. The Authority's function is to develop and administer low-cost housing projects and to assist in correcting housing conditions endangering the health, safety, and welfare of the people residing in the Republic of Palau, which is funded primarily with grant revenue received from the U.S. Department of Housing and Urban Development.

The authority-wide financial statements can be found on pages 16 through 20 of this report.

NOTES TO THE FINANCIAL STATEMENTS

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the authority-wide financial statements. The notes to the financial statements can be found on pages 21 through 39 of this report.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Overview of the Financial Statements, Continued

FUND FINANCIAL STATEMENTS

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is now on Major Funds rather than fund types. The Authority consists of exclusively Enterprise Funds. Enterprise funds utilize the full accrual basis of accounting. The Enterprise method of accounting is similar to accounting utilized by the private sector accounting.

Funds maintained by the Authority are segregated to enhance accountability and control.

Authority-Wide Financial Analysis

Fiscal year 2011 is the ninth year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34. The financial statement focuses on the Authority as a whole. The Authority's financial statements are designed to emulate corporate presentation models whereby all Authority activities are combined into one total. The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Authority. This Statement combines current financial resources (short-term spendable resources) with capital assets. The Statement of Revenues, Expenses, and Changes in Net Assets focuses on both the gross costs and the net costs of Authority activities which are supported mainly by appropriations from Palau National Congress (Olbiil Era Kelulau or OEK) and by other revenues. This approach is intended to summarize and simplify the user's analysis of cost of Authority services to the general public of the ROP.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Authority-Wide Financial Analysis, Continued

Statements of Net Assets
As of September 30, 2011, 2010 and 2009

	2011	2010	2009
Assets			
Current assets:			
Cash and cash equivalents	\$ 1,014,213	\$ 971,330	\$ 929,025
Notes receivable, current portion	296,825	208,450	195,261
Allowance for doubtful accounts	(87,994)	(87,994)	(78,556)
	208,831	120,456	116,705
Accounts receivable, net	13,115	36,431	51,886
Due from grantor agency	30,375	30,375	30,375
Interest receivable	9,590	9,590	9,590
Due from other fund	55,375	55,000	45,000
	1,331,499	1,223,182	1,182,581
Noncurrent assets:			
Notes receivable, net of current portion	1,534,549	1,631,538	1,605,668
Capital assets, net	13,449	23,552	39,555
Other assets	-	-	43,041
	1,547,998	1,655,090	1,688,264
Total Assets	\$ 2,879,497	\$ 2,878,272	\$ 2,870,845

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Authority-Wide Financial Analysis, Continued

Statements of Net Assets
As of September 30, 2011, 2010 and 2009

	2011	2010	2009
Liabilities			
Current Liabilities:			
Due to other fund	\$ 55,375	\$ 55,000	\$ 45,000
Accrued expenses	20,105	15,393	18,163
Total liabilities	75,480	70,393	63,163
 Net Assets			
Invested in capital assets	13,449	23,552	39,555
Restricted	-	1,839,988	2,374,498
Unrestricted	2,790,568	944,339	393,629
Total net assets	2,804,017	2,807,879	2,807,682
Total Liabilities and Net Assets	\$ 2,879,497	\$ 2,878,272	\$ 2,870,845

This schedule is prepared from the Authority's Statement of Net Assets, which is presented on an accrual basis of accounting whereby liabilities and expenses are recorded when incurred, whether paid or not, and revenue is recorded when earned, whether received or not.

Total net assets \$2.80 million as of FY 2011 and \$2.81 million as of FY 2010. There were five (5) new loans approved in FY 2011 totaling \$55,000, all of which are 100% completed as of September 30, 2011 except for one whose contract was just recently awarded.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Authority-Wide Financial Analysis, Continued

Noncurrent assets decreased from \$1.65 million in FY 2010 to \$1.55 million in FY 2011. The decrease is attributed to a decrease in capital assets and notes receivable. Of the total outstanding notes receivable, \$1,630,407 pertains to the Home Rehabilitation Loan Program as of September 30, 2011.

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the Authority, assets exceeded liabilities by \$2,804,017 as of September 30, 2011.

**Operating Revenues for the Years Ended
September 30, 2011, 2010 and 2009**

	2011	2010	2009
Operating revenues:			
Republic of Palau appropriations	\$ 64,000	\$ 60,000	\$ 66,645
Interest on loans	76,955	88,600	74,975
Tenant rental income	6,000	13,550	16,200
National treasury income	9,000	9,000	9,000
Other	4,549	15,605	11,856
Total operating revenues	160,504	186,755	178,676
Provision for loan loss	-	(17,052)	-
Total net operating revenues	\$ 160,504	\$ 169,703	\$ 178,676

The above schedule indicates total revenues realized by the Authority in FY 2011 totaling \$160,504. The OEK contributed \$64,000 and \$9,000 through cost reimbursement grants during FY 2011. The Authority draws down monies from the grant awards for allowable program expenses, except for non-cash transactions, such as depreciation expense and changes in compensated absences. The Authority's intergovernmental revenues and charges for services were sufficient to cover all expenses incurred during the year.

The Authority's net operating revenues decreased by \$9,199 in FY 2011 mainly attributable to lower interest income earned on loans (\$11,645) and decreased Section 8 rental income (\$7,550) arising from the demolition of the Section 8 housing units in the middle of the year. In FY 2010, the Authority recorded a provision for loan loss in the amount of \$17,052.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Authority-Wide Financial Analysis, Continued

**Operating Expenses for the Years Ended
September 30, 2011, 2010 and 2009**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating expenses:			
Salaries and wages	\$ 64,422	\$ 65,458	\$ 64,122
Provision for bad debts	22,631	-	-
Labor and materials	18,787	-	-
Professional fees	10,525	12,000	9,000
Rent expense	10,480	11,320	11,320
Depreciation	10,103	14,549	14,153
Employee benefits	8,248	6,693	6,549
Communication	3,667	2,710	5,312
Repairs and maintenance	3,460	2,848	2,610
Travel	3,412	2,722	2,559
Miscellaneous	<u>9,469</u>	<u>9,105</u>	<u>14,424</u>
 Total operating revenues	 <u>\$ 165,204</u>	 <u>\$ 127,405</u>	 <u>\$ 130,049</u>

The above schedule shows total operating expenses of \$165,204 in FY 2011.

The Authority's operating expenses increased by \$37,799 in FY 2011 due primarily to the \$22,631 provision for possible uncollectability of some identified rental receivables and \$18,787 demolition cost of Section 8 housing.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
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Authority-Wide Financial Analysis, Continued

CAPITAL ASSETS

As of September 30, 2011, 2010 and 2009, the Authority's investment in capital assets (net of accumulated depreciation) for its business-type activities is as reflected in the following schedule:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Residential units	\$ -	\$ 213,431	\$ 213,431
Furniture, fixtures, and equipment	37,328	37,328	38,782
Vehicles	<u>45,979</u>	<u>45,979</u>	<u>45,979</u>
	83,307	296,738	298,192
Accumulated depreciation	<u>(69,858)</u>	<u>(273,186)</u>	<u>(258,637)</u>
	<u>\$ 13,449</u>	<u>\$ 23,552</u>	<u>\$ 39,555</u>

Additional information on the Authority's capital assets can be found in Notes 1 and 6 of the accompanying Notes to Combined Financial Statements.

FUND BALANCE

Fund balance is an analysis of balances and transactions of individual funds, including the reasons for significant changes in fund balances or fund net assets and whether restrictions, commitments, or other limitations significantly affect the availability of fund resources for future use.

As of September 30, 2011, 2010 and 2009, the Authority's fund balance is as reflected in the following schedule:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Invested in capital assets	\$ 13,449	\$ 23,552	\$ 39,555
Restricted	-	1,839,988	2,374,498
Unrestricted	<u>2,790,568</u>	<u>944,339</u>	<u>393,629</u>
Total net assets	<u>\$ 2,804,017</u>	<u>\$ 2,807,879</u>	<u>\$ 2,807,682</u>

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Authority-Wide Financial Analysis, Continued

BUDGETARY INFORMATION

Budgetary financial statements is an analysis of significant variations between original and final budget amounts and between final budget amounts and actual budget results, including reasons for those variations that are expected to have a significant effect on future services or liquidity.

	Budgeted Amounts		Actual Amounts	(Unfavorable) Variance
	<u>Original</u>	<u>Final</u>		
Operating revenues	\$ 152,902	\$ 137,902	\$ 160,504	\$ 22,602
Operating expenses	<u>(152,902)</u>	<u>(137,902)</u>	<u>(165,204)</u>	<u>(27,302)</u>
Operating loss	-	-	(4,700)	(4,700)
Investment income earned	<u>-</u>	<u>-</u>	<u>838</u>	<u>838</u>
Decrease in net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (3,862)</u>	<u>\$ (3,862)</u>

Palau District Housing Authority has no authority to impose taxes to generate revenue. The Authority, as an autonomous agency of the Republic of Palau, receives annual appropriation from the legislative branch, the Olbiil Era Kelulau (Palau National Congress). The Palau National Congress legislative budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. An annual appropriated budget is adopted by the Legislature for Palau District Housing Authority through an Annual Appropriations Act.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
September 30, 2011

Economic Factors and Next Year's Budget and Rates

The following factors were considered in preparing the Authority's budget for the 2012 fiscal year:

- An increase in the collections of loan payments. The increase will be due to additional loan disbursed from previous year due to the Nanden subdivision project (10-housing units).
- The number of loans to be disbursed will be similar to previous years. Plans to duplicate similar program.
- An increase in interest income primarily due to additional loan disbursements.
- Appropriation from the Palau National Government for administrative and operation expenditures.
- Partnership with the National Development Bank of Palau (NDBP).

Future Events that will Financially Impact the Authority

- The Authority will continue its housing programs, but will depend entirely on its limited revolving funds to fund and continue its programs.
- To continue partnership with National Development Bank of Palau (NDBP) in the Energy Efficiency Subsidy Program (EESP). Under this program, the NDBP home loan borrowers may be eligible for loan subsidies of \$3,000 to \$6,000 for incorporating energy efficiency measures into their newly constructed homes.
- Partnership with NDBP to extend assistance towards providing loans through the Energy Efficient Retro-Fit Program.
- To seek and continue partnership to develop similar subdivision housing projects in various States of the Republic of Palau.
- The Palau Housing Authority plans to develop another similar subdivision housing project in Babeldaob.
- The securing of land and the construction of a permanent office building for the Palau Housing Authority.

PALAU DISTRICT HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2011

Contacting the Authority's Financial Management

The Management Discussion and Analysis is intended to provide information concerning known facts and conditions affecting the Authority's operations. This financial report is designed to provide a general overview of the Authority's finances and demonstrate its ability to manage its resources.

For additional information concerning this report, please contact the Executive Director of the Palau District Housing Authority, PO Box 197, Koror, Republic of Palau, 96940, or call (680) 488-6207.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Combined Statements of Net Assets
September 30, 2011

(With comparative totals as of September 30, 2010)

	Major Enterprise Funds					Total 2011	Total 2010
	Operation Fund	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Fund		
ASSETS							
Current assets:							
Cash and cash equivalents (Notes 1, 2 and 3)	\$ 93,113	\$ 53,773	\$ 614,514	\$ 71,799	\$ 181,014	\$1,014,213	\$ 971,330
Notes receivable, current portion (Notes 1, 4 and 9)	-	-	248,872	42,511	5,442	296,825	208,450
Allowance for loan losses (Notes 1 and 4)	-	-	(69,442)	(18,552)	-	(87,994)	(87,994)
	-	-	179,430	23,959	5,442	208,831	120,456
Accounts receivable, net	925	11,686	504	-	-	13,115	36,431
Due from grantor agency	-	-	-	30,375	-	30,375	30,375
Interest receivable	-	-	7,791	1,799	-	9,590	9,590
Due from other fund (Note 5)	375	-	-	-	55,000	55,375	55,000
Total current assets	94,413	65,459	802,239	127,932	241,456	1,331,499	1,223,182
Noncurrent assets:							
Notes receivable, net of current portion (Notes 1, 4 and 9)	-	-	1,381,535	114,949	38,065	1,534,549	1,631,538
Capital assets, net (Notes 1 and 6)	441	13,008	-	-	-	13,449	23,552
Total noncurrent assets	441	13,008	1,381,535	114,949	38,065	1,547,998	1,655,090
Total assets	\$ 94,854	\$ 78,467	\$2,183,774	\$ 242,881	\$ 279,521	\$2,879,497	\$2,878,272

See accompanying notes to the basic financial statements.

PALAU DISTRICT HOUSING AUTHORITY
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Combined Statements of Net Assets, Continued
September 30, 2011

(With comparative totals as of September 30, 2010)

	Major Enterprise Funds					Total 2011	Total 2010
	Operation Fund	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds		
LIABILITIES							
Current Liabilities:							
Due to other fund (Note 5)	\$ -	\$ -	\$ 375	\$ 55,000	\$ -	\$ 55,375	\$ 55,000
Accrued expenses (Note 1)	14,105	-	6,000	-	-	20,105	15,393
	14,105	-	6,375	55,000	-	75,480	70,393
Total liabilities							
Commitments and Contingencies (Note 9)							
NET ASSETS (Note 1)							
Invested in capital assets	441	13,008	-	-	-	13,449	23,552
Restricted	-	-	-	-	-	-	1,839,988
Unrestricted	80,308	65,459	2,177,399	187,881	279,521	2,790,568	944,339
	80,749	78,467	2,177,399	187,881	279,521	2,804,017	2,807,879
Total net assets							
Total liabilities and net assets	\$ 94,854	\$ 78,467	\$2,183,774	\$ 242,881	\$ 279,521	\$2,879,497	\$2,878,272

See accompanying notes to the basic financial statements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Combined Statements of Revenues, Expenses and Changes in Net Assets
Year Ended September 30, 2011

(With comparative totals as of September 30, 2010)

	Major Enterprise Funds					Total 2011	Total 2010
	Operation Fund	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds		
Operating revenues:							
Republic of Palau appropriation	\$ 64,000	\$ -	\$ -	\$ -	\$ -	\$ 64,000	\$ 60,000
Interest on loans	-	-	70,598	4,518	1,839	76,955	88,600
Section 8 income	-	6,000	-	-	-	6,000	13,550
National treasury income	4,500	-	4,500	-	-	9,000	9,000
Other	18	412	3,964	155	-	4,549	15,605
	<u>68,518</u>	<u>6,412</u>	<u>79,062</u>	<u>4,673</u>	<u>1,839</u>	<u>160,504</u>	<u>186,755</u>
Total operating revenues							
Provision for loan loss	-	-	-	-	-	-	(17,052)
	<u>68,518</u>	<u>6,412</u>	<u>79,062</u>	<u>4,673</u>	<u>1,839</u>	<u>160,504</u>	<u>169,703</u>
Net operating revenues							
Operating expenses:							
Salaries and wages	45,993	-	18,429	-	-	64,422	65,458
Provision for bad debts	-	22,631	-	-	-	22,631	-
Labor and materials	-	18,787	-	-	-	18,787	-
Professional fees	4,500	1,525	4,500	-	-	10,525	12,000
Rent expense	5,950	280	4,250	-	-	10,480	11,320
Depreciation	264	9,839	-	-	-	10,103	14,549
Employee benefits	5,922	-	2,326	-	-	8,248	6,693
Communication	472	1,355	1,840	-	-	3,667	2,722
Repairs and maintenance	135	986	2,339	-	-	3,460	2,710
Travel	1,284	182	1,946	-	-	3,412	2,848
Miscellaneous	3,376	2,139	3,859	48	47	9,469	9,105
	<u>67,896</u>	<u>57,724</u>	<u>39,489</u>	<u>48</u>	<u>47</u>	<u>165,204</u>	<u>127,405</u>
Total operating expenses							
Operating income (loss)	<u>622</u>	<u>(51,312)</u>	<u>39,573</u>	<u>4,625</u>	<u>1,792</u>	<u>(4,700)</u>	<u>42,298</u>
Non-operating revenue (expense):							
Interest income	33	218	452	19	116	838	940
Other expense (Note 12)	-	-	-	-	-	-	(43,041)
	<u>33</u>	<u>218</u>	<u>452</u>	<u>19</u>	<u>116</u>	<u>838</u>	<u>(42,101)</u>
Total non-operating revenue (expense)							
Change in net assets	655	(51,094)	40,025	4,644	1,908	(3,862)	197
Total net assets at beginning of year							
	<u>80,094</u>	<u>129,561</u>	<u>2,137,374</u>	<u>183,237</u>	<u>277,613</u>	<u>2,807,879</u>	<u>2,807,682</u>
Total net assets at end of year							
	<u>\$ 80,749</u>	<u>\$ 78,467</u>	<u>\$2,177,399</u>	<u>\$ 187,881</u>	<u>\$ 279,521</u>	<u>\$2,804,017</u>	<u>\$2,807,879</u>

See accompanying notes to the basic financial statements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Combined Statements of Cash Flows
September 30, 2011

(With comparative totals as of September 30, 2010)

	<u>Major Enterprise Funds</u>					<u>Total 2011</u>	<u>Total 2010</u>
	<u>Operation Fund</u>	<u>Section 8 Housing Assistance Program</u>	<u>Home Rehabilitation Loan Program</u>	<u>Low-Cost Housing Program</u>	<u>Non-Major Enterprise Funds</u>		
Cash flows from operating activities:							
Receipts from customers, net	\$ -	\$ 5,772	\$ 77,982	\$ 12,402	\$ 6,054	\$ 102,210	\$ 84,455
Receipts from ROP appropriation	68,500	-	-	-	-	68,500	81,082
Payments to suppliers	(16,074)	(25,458)	(12,654)	(48)	(47)	(54,281)	(50,706)
Payments to employees	(53,629)	-	(20,755)	-	-	(74,384)	(74,920)
Net cash provided by (used in) operating activities	<u>(1,203)</u>	<u>(19,686)</u>	<u>44,573</u>	<u>12,354</u>	<u>6,007</u>	<u>42,045</u>	<u>39,911</u>
Cash flows from investing activities:							
Interest and dividends	33	218	452	19	116	838	940
Other adjustments	-	-	-	-	-	-	1,454
Net cash provided by (used in) investing activities	<u>33</u>	<u>218</u>	<u>452</u>	<u>19</u>	<u>116</u>	<u>838</u>	<u>2,394</u>
Net increase (decrease) in cash and cash equivalents	(1,170)	(19,468)	45,025	12,373	6,123	42,883	42,305
Cash and cash equivalents at beginning of year	<u>94,283</u>	<u>73,241</u>	<u>569,489</u>	<u>59,426</u>	<u>174,891</u>	<u>971,330</u>	<u>929,025</u>
Cash and cash equivalents at end of year	<u>\$ 93,113</u>	<u>\$ 53,773</u>	<u>\$ 614,514</u>	<u>\$ 71,799</u>	<u>\$ 181,014</u>	<u>\$1,014,213</u>	<u>\$ 971,330</u>

See accompanying notes to the basic financial statements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Combined Statements of Cash Flows, Continued
September 30, 2011

(With comparative totals as of September 30, 2010)

	Major Enterprise Funds					Total 2011	Total 2010
	Operation Fund	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds		
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:							
Operating income (loss)	\$ 622	\$ (51,312)	\$ 39,573	\$ 4,625	\$ 1,792	\$ (4,700)	\$ 42,298
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities							
Depreciation	264	9,839	-	-	-	10,103	14,549
Provision for bad debts	-	22,631	-	-	-	22,631	-
Provision for loan loss	-	-	-	-	-	-	17,052
(Increase) decrease in assets:							
Accounts receivable	(925)	(640)	2,250	-	-	685	15,455
Notes receivable	-	-	(3,330)	7,729	4,215	8,614	(46,673)
Due from other funds	(375)	-	-	-	-	(375)	(10,000)
Increase (decrease) in liabilities:							
Accrued expenses	(789)	(204)	5,705	-	-	4,712	(2,770)
Due to other funds	-	-	375	-	-	375	10,000
Net cash provided by (used in) operating activities	\$ (1,203)	\$ (19,686)	\$ 44,573	\$ 12,354	\$ 6,007	\$ 42,045	\$ 39,911

See accompanying notes to the basic financial statements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies

The Palau District Housing Authority (the Authority), a component unit of the Republic of Palau (ROP), was established by Public Law 4-5-5 (June 20, 1970) of the Palau District Legislature (of the Trust Territory of the Pacific Islands). Its purpose is to develop and administer low cost housing and urban renewal projects and to assist in correcting housing conditions endangering the health, safety, and welfare of the people of the ROP. The Authority was reorganized by Trust Territory Public Law 5-37 (April 5, 1973). Upon emergence of the Republic of Palau Constitutional Government (January 1, 1981), the Authority was transferred to the Republic of Palau. The Authority is a public corporation administered by a five-member Board of Directors appointed by the President of the Republic of Palau with the advice and consent of the Olbiil Era Kelulau (OEK – Palau National Congress).

The Authority's primary operations are comprised of a number of housing and grant programs as follows:

Major Enterprise Funds

Section 8 Housing Assistance Program

This program provides temporary housing for rental to assist low-income families who lack sufficient income to obtain safe, decent, and sanitary housing. The program was originally funded through the U.S. Department of Housing and Urban Development (HUD), until it was phased-out in December 2004. However, the program has been able to sustain itself and continue to provide this service.

Home Rehabilitation Loan Program

The Home Rehabilitation Loan Program provides long-term financing to low income and moderate income families to rehabilitate existing dwellings or construct new single-family housing units. This Program is made possible through the initial funding from the U.S. Department of Housing and Urban Development (HUD). The maximum amount that can be borrowed for a new single family dwelling is \$35,000 at 4.5% interest per annum with a 25 year term. The maximum loan amount to rehabilitate an existing dwelling is \$5,000 with a 10 year term at 3% interest rate per annum, and \$10,000 with a 15 year term at 4.5% interest rate per annum.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Major Enterprise Funds, Continued

Low-Cost Housing Program

The U.S. Department of Housing and Urban Development (HUD) was the primary source of funds for the Loan Fund Housing Program. This program initially provided funding for loans to low-income families for up to \$12,000, payable over a period of 30 years, at an interest rate of 3 percent per annum to rehabilitate/construct family homes.

Currently, under this loan program and with the initial funding from HUD and U.S. Department of Agriculture (USDA), the Home Improvement and Repair Assistance Program was established specifically to provide low cost and long-term loans to low income and very low-income senior citizens, 60 years old and over, to rehabilitate their homes. Under this program, the borrower can obtain a maximum loan of \$5,000 with interest rate of 3 percent per annum payable over a 10-year period.

Non-Major Enterprise Funds

The following funds was determined to be non-major enterprise funds for the fiscal year ended September 30, 2011:

Emergency Housing Revolving Loan Program

The Emergency Housing Revolving Loan Program was established as an emergency loan program for citizens of the Republic of Palau for whose homes were destroyed by natural disaster or fire. The Program was funded by a \$500,000 appropriation from the Republic of Palau. Pursuant to Republic of Palau Public Law 6-26, §4, the Program was initially established to provide loans to private homeowners whose homes were destroyed or made uninhabitable because of damage done by storm Utor. Loans are available from a minimum of \$500 to a maximum amount of \$30,000, with repayment terms ranging from 3-to 30 years at an interest rate of 3 percent per annum. During the fiscal year ending September 30, 2002, the Authority remitted \$250,000 of the initial funding back to the Republic of Palau National Government.

Transitional/Emergency Shelter Program

This Program provides short-term temporary housing to individuals or families who become victims of domestic violence or abuse and whose homes are destroyed due to fire or natural disaster. The Program was originally funded through the HUD.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Local Funds

Local funds consist of appropriations from Republic of Palau for general operations of the Authority.

Measurement Focus, Basis of Accounting, and Basis of Presentation

During 2003, the Authority implemented GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Government*, 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 Interpretation No. 6 *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB Statement No. 34 creates new basic financial statements for reporting on the Authority's financial activities. The new financial statements now include government-wide financial statements prepared on an accrual basis of accounting and fund accounting which present information for individual major funds rather than by fund type. Requirements in order to comply also include adopting depreciation on capital assets and classifying assets and liabilities as current and non-current.

GASB Statement No. 37 clarifies certain provisions of GASB Statement No. 34, including the required content of the Management Discussion and Analysis, the classification of program revenues and the criteria for determining major funds. GASB Statement No. 38 modifies, establishes and rescinds certain financial statement note disclosures. GASB Interpretation No. 6 clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice.

The accounts of the Authority are organized and operated on the basis of funds and grant programs. A fund is an independent fiscal year and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

The Authority has elected to use proprietary fund types as its principal reporting. Proprietary funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Authority's proprietary funds are enterprise funds used to account for those operations that are financed and operated in a manner similar to private business or where the Authority has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability.

The general purpose financial statements of the Palau District Housing Authority have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Government Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Palau District Housing Authority has implemented GASB No. 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The financial statements include certain prior-year summarized comparative information in total but not by fund. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Authority's audited financial statements for the year ended September 30, 2010, from which the summarized information was derived.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Recent Pronouncements

In March 2009, GASB issued Statement No 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement is to improve financial reporting by contributing to the GASB efforts to codify all generally accepted accounting principles (GAAP) for State and Local Governments so that they derive from a single source. This Statement is effective upon issuance. The Authority does not believe that the implementation of this Statement will have a material effect on its financial statements.

In March 2009, GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for State and Local governments, and addresses three issues from the AICPA's literature – related party transactions, going concern considerations and subsequent events. This Statement is effective upon issuance. The implementation of this Statement did not have a material effect on the accompanying financial statements of the Authority.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. The Statement updates and improves existing standards regarding financial reporting of certain financial instruments and external pools. The Statement is effective for financial statements prepared by state and local governments for periods beginning after June 15, 2010, with earlier application encouraged. The implementation of this Statement did not have a material effect on the accompanying financial statements of the Authority.

In November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*—an amendment of GASB Statements No. 14 and No. 34. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged. Management has not evaluated the effect that the implementation of this Statement will have on the financial statements of the Authority.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Recent Pronouncements, Continued

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations;
2. Accounting Principles Board Opinions; and
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

Hereinafter, these pronouncements collectively are referred to as the *FASB and AICPA Pronouncements*. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

Budgets

Budgets are prepared on an annual basis for each major operating program and are used as a management tool throughout the accounting cycle. Budgets, however are not legally adopted or legally required for financial statement presentation.

The Authority's governing body, the Board of Directors, adopts budgets on a program or fund level basis. These budgets are submitted by the Authority's Executive Director, and approved by resolutions of the Board of Directors. The Authority's Board of Directors may authorize revisions to the budget based on the availability of financial resources. Formal budget revisions are authorized in the same manner as original budget submissions

Annual budgets are adopted for all Enterprise Funds. Throughout the fiscal year, the Authority monitors and evaluates expenditures rates and patterns. However, timely notice is not given to executive management regarding forthcoming changes in objectives or other conditions that may cause significant variations from approved budget-defined plans.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Management's Use of 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the purposes of the Statement of Net Assets and Statement of Cash Flows, the Authority considers cash and cash equivalents to be cash on hand, cash in checking and savings accounts, and time certificates of deposit of less than ninety-day maturities. All of the Authority's cash are with a federally insured bank, \$250,000 of which is subject to coverage by federal insurance as of September 30, 2011 and 2010, respectively, with the remaining balance exceeding insurable limits. The Authority's cash equivalents, on the other hand, are with a financial institution that is not covered by the Federal Deposit Insurance Corporation (FDIC). The Authority does not require collateralization of its bank accounts and, therefore, amounts in excess of insurable limits are uncollateralized. Deposits in excess of federal depository insurance are considered uncollateralized by GASB Statement No. 40. Custodial credit risk for deposits is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Authority's cash and cash equivalents exceeding FDIC insurable limits is \$772,858 and \$0 as of September 30, 2011 and 2010, respectively.

Lending Policy

The Authority extends loans to qualifying residents of the Republic of Palau for rehabilitating existing dwellings or for constructing approved low-cost housing. The loans have terms from five to thirty years at an interest rate of 3% and 4.5%. Loans are restricted to a maximum ninety percent (90%) debt (aggregate of all debts associated with the property) to the appraised value of the property ratio or ninety percent (90%) of the estimated replacement cost, whichever is lower. The loans are collateralized by the property being rehabilitated.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may be uncollectible, based on evaluation of the collectability of loans and prior loan loss experience. The evaluation takes into consideration such factors as specific problem loans and current economic conditions that may affect the borrowers' ability to pay. The Authority recognizes bad debts using the allowance method and is only written-off after approval by management and subsequent reporting to the Board of Directors.

Capital Assets

All capital assets with a value greater than \$500 and a useful life over one year are capitalized.

The cost of repairs and maintenance is charged to operations as incurred and improvements are capitalized. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Assets are depreciated using the following depreciation guidelines:

<u>Category</u>	<u>Useful Life – Years</u>
Residential units	28
Furniture, fixtures and equipment	5
Vehicles	5

Upon retirement or other disposition of capital assets recorded, the cost and related accumulated depreciation are removed from the respective program's or fund's accounts and any gain or loss is included in the respective program's or fund's current operations.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Compensated Absences

Compensated absences are those absences for which employees will be paid, such as vacation and sick leave. Employees are credited 104, 156 or 208 hours per fiscal year, based on their lengths of service. The accumulation of vacation leave credits is limited to 360 at fiscal year-end while that of sick leave credits is unlimited. Both are convertible to pay upon termination of employment. The Authority recognizes as a liability all vested vacation and sick leave benefits accrued by its employees. When the employees use vacation and sick leave benefits, the liability account is reduced accordingly. At September 30, 2011 and 2010, compensated absences payable to employees were \$14,105 and \$13,782, respectively, and are recorded as a component of accrued expenses in the accompanying Combined Statement of Net Assets. At September 30, 2011 and 2010, all compensated absences are current.

Income Tax

Based on 34 PNC 7006, the Authority is exempt from all national and state non-payroll taxes or fees.

Net Assets

The Authority's net assets are classified as follows:

Invested in capital assets - This represents the Authority's total investment in capital assets, net of accumulated depreciation.

Restricted net assets – This includes grants from HUD, USDA, and contributions received from the Trust Territory of the Pacific Islands for the establishment of the Home Rehabilitation Revolving Loan Program and the Low-Cost Housing Revolving Loan program, respectively. It also includes contributions received from the Republic of Palau National Government for the establishment of Emergency Loan Program.

Unrestricted net assets – This includes resources derived from government appropriations. These resources are used for transactions relating to the general operations of the Authority and may be used at the discretion of the governing board to meet current expenses for any purpose.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Classification of Revenues

The Authority has classified its revenues as either operating or non-operating according to the following criteria:

Operating Revenues – Operating revenues include activities that have the characteristics of exchange transactions, such as federal, state and local grants and contracts and federal appropriations.

Non-operating Revenues – Non-operating revenues include activities that have the characteristics of nonexchange 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*.

Advertising

For the fiscal years ending September 30, 2011 and 2010, the Authority incurred advertising costs totaling \$495 and \$1,285, respectively. These costs primarily relate to construction bids and related procurement solicitation costs.

(2) Cash and cash equivalents

Cash and cash equivalents at September 30, 2011 and 2010 consist of the following:

	<u>2011</u>	<u>2010</u>
Cash	\$ 501,648	\$ 521,330
Time certificates of deposit	<u>512,565</u>	<u>450,000</u>
	<u>\$ 1,014,213</u>	<u>\$ 971,330</u>

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(3) Deposits and investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. 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 the Authority or its agent in the Authority'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 Authority'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 Authority'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, the Authority'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. The Authority has an investment and deposit policy for custodial credit risk. For deposits, a general depository agreement pursuant to HUD regulations, must be executed by the Authority and the depository. The depository bank must be a bank or financial institution whose deposits are insured by FDIC, Federal Savings and Loan Insurance Corporation or the National Credit Union Administration and all deposits must be fully collateralized by U.S. securities.

PALAU DISTRICT HOUSING AUTHORITY
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Notes to Combined Financial Statements
September 30, 2011 and 2010

(3) Deposits and investments, Continued

For credit risk in the case of deposits, there is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. As of September 30, 2011 and 2010, the carrying amount of the Authority's total cash and cash equivalents was \$1,014,213 and \$971,330, respectively with a corresponding bank balance of \$1,022,858 and \$975,464, respectively. From these deposits, \$250,000 and \$975,464 at September 30, 2011 and 2010, respectively was subject to coverage by FDIC. The Authority does not require collateralization of bank accounts, and therefore, amounts in excess of insurable limits are uncollateralized and are subject to custodial credit risk.

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 the Authority or its agent in the Authority'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 Authority'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 Authority'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, 2011 and 2010, the Authority did not have investments subject to GASB Statement No. 40.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(4) Notes Receivable

A summary of notes receivable at September 30, 2011 and 2010 consists of the following:

	2011	2010
Home Rehabilitation loans	\$ 1,630,407	\$ 1,627,077
Emergency Loan Revolving Fund loans	43,507	47,722
Low-Cost Housing loans	157,460	165,189
	1,831,374	1,839,988
Current portion	(296,825)	(208,450)
Long-term notes receivable, net of current portion	\$ 1,534,549	\$ 1,631,538
Allowance for loan losses	\$ (87,994)	\$ (87,994)

A summary of the activity in the allowance for loan losses is as follows:

	2011	2010
Balance at beginning of year	\$ 87,994	\$ 78,556
Additions to provision for loan loss	-	17,052
Loans charged-off	-	-
Recoveries of loans charged-off	-	(7,614)
Balance at end of year	\$ 87,994	\$ 87,994

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(5) Interfunds

The Authority maintains interfund receivable and payable accounts for all housing projects and funds that it administers and reports interfund transfers between many of its funds. The outstanding balances between funds result mainly from time lags between the date that (1) interfund goods and services are provided or reimbursable expenditures occur; (2) transactions are recorded in the accounting system; and (3) payments between funds are made. The amounts payable to the revolving fund are expected to be collected in the subsequent year. The composition of the inter-fund receivable and payable balances as of September 30, 2011 is as follows:

	Due from Other Funds	Due to other Funds	Net Receivable (Payable)
Major Enterprise Funds			
Low-Cost Housing Programs	\$ -	\$ 55,000	\$ (55,000)
Non-Major Enterprise Funds	<u>55,000</u>	<u>-</u>	<u>55,000</u>
	<u>\$ 55,000</u>	<u>\$ 55,000</u>	<u>\$ -</u>

(6) Capital Assets

A schedule of changes in capital assets for the fiscal years ended September 30, 2011 and 2010 is shown below:

Capital assets activity for the fiscal year ended September 30, 2011:

	Balance 09/30/10	Additions	Disposal/ Adjustment	Balance 09/30/11
Residential units	\$ 213,431	\$ -	\$ 213,431	\$ -
Furniture, fixtures, and equipment	37,328	-	-	37,328
Vehicles	<u>45,979</u>	<u>-</u>	<u>-</u>	<u>45,979</u>
	296,738	-	213,431	83,307
Accumulated depreciation	<u>(273,186)</u>	<u>(10,103)</u>	<u>213,431</u>	<u>(69,858)</u>
	<u>\$ 23,552</u>	<u>\$ (10,103)</u>	<u>\$ 426,862</u>	<u>\$ 13,449</u>

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(6) Capital Assets, Continued

Capital assets activity for the fiscal year ended September 30, 2010:

	Balance 09/30/09	Additions	Disposal/ Adjustment	Balance 09/30/10
Residential units	\$ 213,431	\$ -	\$ -	\$ 213,431
Furniture, fixtures, and equipment	38,782	-	(1,454)	37,328
Vehicles	45,979	-	-	45,979
	298,192	-	(1,454)	296,738
Accumulated depreciation	(258,637)	(14,549)	-	(273,186)
	<u>\$ 39,555</u>	<u>\$ (14,549)</u>	<u>\$ (1,454)</u>	<u>\$ 23,552</u>

Depreciation expense for the years ended September 30, 2011 and 2010 was \$10,103 and \$14,549, respectively.

The residential units are constructed on properties leased from the Trust Territory Government, which properties were transferred to Palau Public Land Authority in accordance with U.S. Department of the Interior Secretarial Order No. 2969. The properties were subsequently transferred to the Koror Municipal Public Lands Authority through quitclaim deeds dated May 14, 1980 and February 16, 1983. On October 6, 2009, the lease from the Koror Municipal Public Lands Authority was renewed for fifty years.

(7) Employees Retirement Plan

The Authority contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multi-employer pension plan established and administered by the Republic of Palau. The Fund issues a stand-alone financial report which is available at its office site.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent (2%) of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members, who retire at or after age 60, or with 30 years of vesting service, are entitled to retirement benefits.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(7) Employees Retirement Plan, Continued

Republic of Palau Public Law 2-26 is the authority under which benefit provisions and contributions rates are established. Member contribution rates are established by Republic of Palau Public Law 2-26 at six percent (6%) of total payroll and are matched dollar for dollar by the employer. The Authority contributed \$3,865, \$3,816 and \$3,752 for fiscal years 2011, 2010, and 2009, respectively.

Under the provisions of the Republic of Palau Public Law 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code.

The Fund utilizes the actuarial cost method termed "level aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation. The following is the statement of actuarial assumptions as of October 1, 2009 applicable to the plan year ending September 30, 2009 of the ROP Civil Service Pension Plan:

Actuarial Cost Method: Normal costs are calculated under the level aggregate method.

Investment Income	: 8.5% per year
Expenses:	: \$300,000 each year
Salary Increase:	: 3% per year
Mortality	: 1984 Unisex Pension Mortality Table
Disabled Mortality	: PBGC Mortality Table for Disabled Persons Receiving Social Security
Retirement Age	: Earlier of age 60 or 30 Years of Total Service

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

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(7) Employees Retirement Plan, Continued

Based on the actuarial valuation of the Fund as of October 1, 2009 issued in August 2010, the actuarial valuation determined the unfunded pension benefit obligation as follows:

Present value of accrued benefits as of October 1, 2009:

Active participants	\$ 56,060,970
Inactive participants with vested deferred benefits	1,779,610
Participants in pay status	<u>47,666,805</u>
Total pension benefit obligation	105,507,385
Market value of assets	<u>41,254,319</u>
Unfunded benefit obligation	<u>\$ 64,253,066</u>
Funded Ratio as of 10/1/2009 (ratio of assets to liabilities)	<u>39.1%</u>

(8) Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The Authority has elected to be self-insured for the risks of loss to which it is exposed.

(9) Commitments and Contingencies

Litigation

The Authority is subject to various claims and other legal actions in the normal course of business. The Authority consults its legal counsel and the Office of the Attorney General of the Republic of Palau whenever there is a potential or asserted claim, and relies on the advice of counsel for direction and for establishing reserves for potential unfavorable outcomes.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(9) Commitments and Contingencies, Continued

The Authority has initiated several foreclosure actions now pending in the Trial Division of the Supreme Court of Palau (the Court) against six (6) borrowers who defaulted on rehabilitation loans whose principal and interest balance approximate \$50,549 as of September 30, 2011. The Authority intends to take the following courses of action with respect to these matters: (1) renegotiate the loan; (2) pursue the claim in Court to recover the amount through judgments for monetary awards; or (3) pursue the claim in court to recover the amount through judgments for foreclosure on mortgaged properties.

Commitments

The Authority entered a lease agreement with Koror State Government for a period of fifty years (50) years expiring on October 2059. Also, the Authority's operations are conducted from premises under a lease agreement expiring on December 4, 2011.

Future lease payments are as follows:

Years ended September 30, 2012	\$ 2,224
2013	524
2014	524
2015	524
2016	524
2017-2021	2,622
2022-2026	2,622
2027-2031	2,622
2032-2036	2,622
2037-2041	2,622
2042-2046	2,622
2047-2051	2,622
2052-2056	2,622
2057-2059	<u>1,573</u>
	<u>\$ 26,869</u>

At September 30, 2011 and 2010, rent expense was \$10,480 and \$11,320, respectively.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Notes to Combined Financial Statements
September 30, 2011 and 2010

(10) National Government Contributions

For the years ended September 30, 2011 and 2010, the Republic of Palau appropriated and contributed the following to the Authority:

	<u>2011</u>	<u>2010</u>
For operational costs of employees	\$ 64,000	\$ 60,000
Cost reimbursement	<u>9,000</u>	<u>9,000</u>
	<u>\$ 73,000</u>	<u>\$ 69,000</u>

(11) Economic Dependency

The PHA receives a substantial amount of its support from interests received from private sector and government donors. A significant reduction in the level of this support, if this were to occur, may have an adverse effect on the Authority's programs and activities. As of September 30, 2011 and 2010, the Authority received 55% and 58%, respectively, of its support from the interests received from private sector, and 45% and 42%, respectively, from government donors.

(12) Other expense

At September 30, 2010, the Authority has determined to write-off the amount of \$43,041 capitalized expenditures recorded as other assets in prior years. The amount written-off was reported in the non-operating expense in the accompanying Combined Statements of Revenues, Expenses and Changes in Net Assets.

(13) Reclassifications

Certain reclassifications have been made to the prior year's financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

(14) Subsequent Events

The Authority has evaluated subsequent events from September 30, 2011 through December 7, 2011, the date the financial statements were available to be issued. The Authority did not note any subsequent events requiring disclosure or adjustment to the accompanying financial statements.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

Supplementary Statements of Revenues, Expenses, and Changes in Net Assets - Budget and Actual
Year Ended September 30, 2011

	Budgeted Amounts			Actual Amounts	(Unfavorable) Variance
	<u>Original</u>	<u>Revision</u>	<u>Final</u>		
Operating revenues	\$ 152,902	\$ (15,000)	\$ 137,902	\$ 160,504	\$ 22,602
Operating expenses:					
Salaries and wages including employee benefits	82,000	-	82,000	72,670	9,330
Provision for bad debts	-	-	-	22,631	(22,631)
Labor and materials	35,500	(15,000)	20,500	18,787	1,713
Professional fees	3,500	-	3,500	10,525	(7,025)
Rent	11,280	-	11,280	10,480	800
Depreciation	-	-	-	10,103	(10,103)
Communication	3,000	-	3,000	3,667	(667)
Repairs and maintenance	2,000	-	2,000	3,460	(1,460)
Travel	3,000	-	3,000	3,412	(412)
Miscellaneous	12,622	-	12,622	9,469	3,153
Total operating expenses	<u>152,902</u>	<u>(15,000)</u>	<u>137,902</u>	<u>165,204</u>	<u>(27,302)</u>
Operating loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4,700)</u>	<u>(4,700)</u>
Non-operating revenues:					
Investment income earned	<u>-</u>	<u>-</u>	<u>-</u>	<u>838</u>	<u>838</u>
Total non-operating expense, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>838</u>	<u>838</u>
Decrease in net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (3,862)</u>	<u>\$ (3,862)</u>

**PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)**

**INDEPENDENT AUDITOR'S REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE**

Year Ended September 30, 2011

J. Scott Magliari
& COMPANY

CERTIFIED PUBLIC ACCOUNTANT

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**INDEPENDENT AUDITOR'S 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**

To the Board of Directors
Palau District Housing Authority

I have audited the financial statements of Palau District Housing Authority (the Authority) as of and for the year ended September 30, 2011, and have issued my report thereon dated January 13, 2012. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing the audit, I considered the Authority's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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 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.


My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be a material weakness, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

I noted certain matters that I reported to the management of the Authority in a separate letter dated January 13, 2012.

This report is intended solely for the information of the Board of Directors and management of the Palau District Housing Authority, the Office of the Public Auditor of Palau, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be, and should not be used by anyone other than the specified users. However, this report is also a matter of public record.


Koror, Republic of Palau
January 13, 2012

**PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)**

STATISTICAL SECTION

Year Ended September 30, 2011

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

NET ASSETS
Last Six Fiscal Years Ending September 30

	2011	2010	2009	2008	2007	2006	2005
Invested in capital assets	\$ 13,449	\$ 23,552	\$ 39,555	\$ 22,424	\$ 28,175	\$ 35,481	\$ 48,713
Restricted	-	1,839,988	2,374,498	2,344,123	2,312,086	2,312,086	2,312,086
Unrestricted	2,790,568	944,339	393,629	345,529	278,135	195,475	138,455
Total Net Assets	\$2,804,017	\$2,807,879	\$2,807,682	\$2,712,076	\$2,618,396	\$2,543,042	\$2,499,254

Source: Annual reports on audited financial statements for the past seven fiscal years.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

CHANGES IN NET ASSETS
Last Six Fiscal Years Ending September 30

	2011	2010	2009	2008	2007	2006	2005
Operating revenues							
Republic of Palau appropriation	\$ 64,000	\$ 60,000	\$ 66,645	\$ 67,000	\$ 67,000	\$ 67,000	\$ 67,000
Interest on loans	76,955	88,600	74,975	63,740	61,479	45,341	38,266
Section 8 income	6,000	13,550	16,200	16,400	15,300	13,812	11,928
National treasury income	9,000	9,000	9,000	8,500	8,500	8,000	8,000
Other operating revenues	4,549	15,605	11,856	6,387	16,469	7,581	7,546
Federal contributions	-	-	-	-	4,050	-	19,516
Provision for loan losses	-	(17,052)	-	-	-	-	-
Total operating revenues, net	160,504	169,703	178,676	162,027	172,798	141,734	152,256
Operating expenses							
Salaries and wages	64,422	65,458	64,122	63,552	59,907	54,929	50,437
Provision for bad debts	22,631	-	-	-	-	-	-
Labor and materials	18,787	-	-	-	-	-	-
Professional fees	10,525	12,000	9,000	9,000	9,380	8,500	10,723
Rent expense	10,480	11,320	11,320	11,890	11,320	10,200	9,350
Depreciation	10,103	14,549	14,153	8,265	9,606	10,198	20,870
Employee benefits	8,248	6,693	6,549	6,373	5,748	5,309	4,962
Communication	3,667	2,722	5,312	3,446	2,925	2,919	2,883
Repairs and maintenance	3,460	2,710	2,610	2,699	2,666	3,888	2,228
Travel	3,412	2,848	2,559	2,887	7,823	9,040	2,930
Other operating expenses	9,469	9,105	14,424	11,490	12,928	12,208	9,701
Total operating expenses	165,204	127,405	130,049	119,602	122,303	117,191	114,084
Operating income	(4,700)	42,298	48,627	42,425	50,495	24,543	38,172
Non-operating revenues (expenses)							
Investment income earned	838	940	16,604	19,218	24,859	22,279	12,903
Other expense	-	(43,041)	-	-	-	-	-
Total non-operating revenues	838	(42,101)	16,604	19,218	24,859	22,279	12,903
Change in net assets	\$ (3,862)	\$ 197	\$ 65,231	\$ 61,643	\$ 75,354	\$ 46,822	\$ 51,075

Source: Annual reports on audited financial statements for the past seven fiscal years.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

REVENUES BY SOURCE
Last Six Fiscal Years Ending September 30

Function	2011	2010	2009	2008	2007	2006	2005
ROP Appropriations	\$ 64,000	\$ 60,000	\$ 66,645	\$ 67,000	\$ 67,000	\$ 67,000	\$ 67,000
Interest on loans	76,955	88,600	74,975	63,740	61,479	45,341	38,266
Section 8 income	6,000	13,550	16,200	16,400	15,300	13,812	11,928
National treasury income	9,000	9,000	9,000	8,500	8,500	8,000	8,000
Other operating revenues	4,549	15,605	11,856	6,387	16,469	7,581	7,546
Federal contributions	-	-	-	-	-	-	19,516
Total Revenues	\$ 160,504	\$ 186,755	\$ 178,676	\$ 162,027	\$ 168,748	\$ 141,734	\$ 152,256

Source: Annual reports on audited financial statements for the past seven fiscal years.

PALAU DISTRICT HOUSING AUTHORITY
(A Component Unit of the Republic of Palau)

SCHEDULE OF EXPENSES

Last Six Fiscal Years Ending September 30

Function	2011	2010	2009	2008	2007	2006	2005
Salaries and wages	\$ 64,422	\$ 65,458	\$ 64,122	\$ 63,552	\$ 59,907	\$ 54,929	\$ 50,437
Provision for bad debts	22,631	-	-	-	-	-	-
Labor and materials	18,787	-	-	-	-	-	-
Professional fees	10,525	12,000	9,000	9,000	9,380	8,500	10,723
Rent expense	10,480	11,320	11,320	11,890	11,320	10,200	9,350
Depreciation	10,103	14,549	14,153	8,265	9,606	10,198	20,870
Employee benefits	8,248	6,693	6,549	6,373	5,748	5,309	4,962
Communication	3,667	2,722	5,312	3,446	2,925	2,919	2,883
Repairs and maintenance	3,460	2,710	2,610	2,699	2,666	3,888	2,228
Travel	3,412	2,848	2,559	2,887	7,823	9,040	2,930
Other operating expenses	9,469	9,105	14,424	11,490	12,928	12,208	9,701
Total Expenses	\$ 165,204	\$ 127,405	\$ 130,049	\$ 119,602	\$ 122,303	\$ 117,191	\$ 114,084

Source: Annual reports on audited financial statements for the past seven fiscal years.