

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

FINANCIAL STATEMENTS,
ADDITIONAL INFORMATION
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2014 and 2013

INDEPENDENT AUDITORS' REPORT

Board of Directors
Palau Public Utilities Corporation:

Report on Financial Statements

We have audited the accompanying financial statements of the Palau Public Utilities Corporation (PPUC), a component unit of the Republic of Palau, which comprise the statements of net position as of September 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Palau Public Utilities Corporation as of September 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 15 be presented to supplement the basic financial statements. Such information, although not 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 Financial Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The combining statement of net position and combining statement of revenues, expenses and changes in net position on pages 31 and 32 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining statement of net position and combining statement of revenues, expenses and changes in net position are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining statement of net position and combining statements of revenues, expenses and changes in net position are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2015, on our consideration of PPUC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PPUC's internal control over financial reporting and compliance.

Deloitte + Touche LLP

June 25, 2015

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Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

This Management's Discussion and Analysis (MD&A) presents the Palau Public Utilities Corporation's financial performance during the fiscal year ended September 30, 2014. Please read it in conjunction with the audited financial statements as of and for the year ended September 30, 2014, which follow this section.

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

MISSION AND OPERATIONS

Initially created as Public Utilities Corporation (PUC) on July 6, 1994, PUC was mandated by law to plan, develop and execute an electrification plan for the entire Republic of Palau. Republic of Palau Public Law (RPPL) No. 9-4 approved on June 6, 2013 merged PUC with the one year old Palau Water & Sewer Corporation (PWSC) to create one comprehensive utility corporation designated as Palau Public Utilities Corporation (PPUC), wholly owned by the Republic of Palau (ROP).

A master plan developed for PPUC in 2009 is now outdated. The PPUC management team is currently developing a strategic plan that will map out three (3) to five (5) years of strategic direction for PPUC.

Electric Power Operation:

To date, PPUC-Electric Power Operation (EPO) has succeeded in meeting its electrification mandate with the exception of the three southern-most islands of Tobi, Sonsorol and Pulo Anna. Due to distance and isolation, electrification of these islands has been slow in developing.

PPUC-EPO operates five (5) power systems throughout Palau. The two largest systems are located in Koror and Babeldaop, feeding the KB grid that services roughly 95% of Palau's population. The remaining three smaller power systems are located in Peleliu, Angaur and Kayangel servicing less than five hundred people combined. The power systems are primarily fossil fuel driven which makes PPUC vulnerable to spikes in the fuel market.

In step with the National Energy Policy (NEP), PPUC has established a Renewable Energy Division (created in 2010), tasked with research, exploration and development of PPUC's renewable energy sector. The division has already undertaken responsibility for the maintenance of the Ngerulmud Capitol Solar System as well as management and maintenance of PPUC's solar system installed at the Palau International Airport. In partnership with the Palau Energy Office, the division continues to pursue opportunities for expanding PPUC's Renewable Energy (RE) platforms, and has to date achieved 2% of its goal of achieving 20% RE by the year 2020. In 2014, management started negotiating a power purchase agreement with an independent power producer for purchase of energy generated by their proposed 5MW solar plant. The negotiation was hindered by the provision of the RPPL No. 9-4, Section 408 that requires approval of the President and presiding officers of the OEK when PPUC enters into business negotiations involving operating or managerial control to a party other than PPUC. The management team is currently reviewing the contract agreement with the legal counsel. Should this negotiation and approval of the contract agreement materialize, PPUC will have achieved roughly 13% of its RE goal.

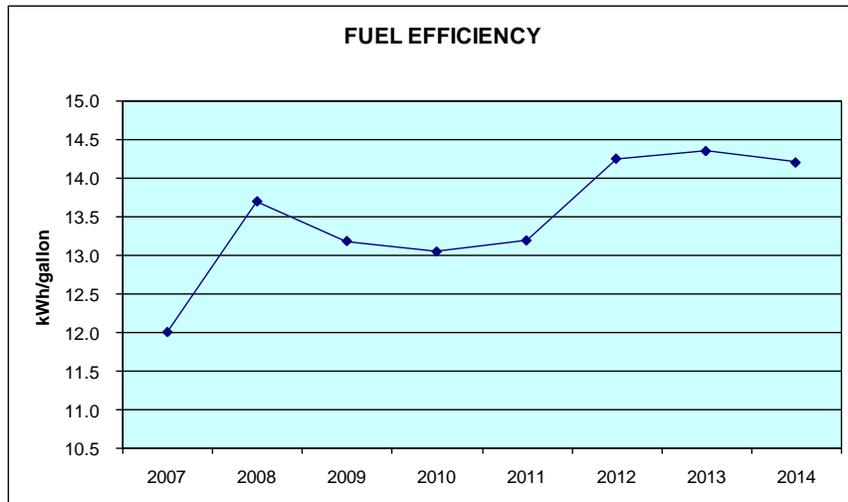
In addition to energy alternatives, PPUC continues its efforts toward fuel efficiency and reduction of energy losses with upgrades to its aging infrastructure and equipment. To date, PPUC has achieved the following:

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- Installed and commissioned two 5MW generators at the Malakal Power Plant on August 11, 2011. With the new larger units in operation, PPUC has realized fuel savings evidenced by the fuel economy graph below.
- Acquired four small 0.5MW generators for backup power through a grant aid for over \$2M during FY2012.
- Commissioned in FY2014 a new power plant facility equipped with two brand new 5MW baseload generators at its Aimeliik location. This project was funded by a grant from Japan to ROP, of which PPUC is the beneficiary.
- Recently contracted and concluded feasibility and assessment studies for the following projects, aimed at improving efficiencies and reducing losses:
 - A feasibility study for the upgrade and expansion of the SCADA (Supervisory Control And Data Acquisition) system which recommended improvements in two Phases. Implementation of Phase I Upgrade is on-going. The outcome of this project will provide real time collection of grid performance data including control which will allow for efficient system monitoring and control, thereby reducing system losses.
 - A conditions assessment study for 3 storage tanks at Aimeliik Power Plant Tank Farm as part of environmental protection measures and enhancing fuel supply security for PPUC plants. PPUC is working on the award to rehabilitate and repair the tanks. Completion of the project will prevent catastrophic environmental degradation due to tank failures and ensure a continuous supply of diesel fuel to the Aimeliik Power Plant.
 - A Transmission and Distribution lines Assessment/Investigation in priority areas of Koror and Babeldaob using Radio Frequency and Ultra Sonic Technology which has identified 12 areas of concern that require pole hardware and device replacement. PPUC has completed the repair/replacement to address these findings.

The chart below reflects PPUC's overall generation performance for the last eight years. As seen in the graph, management undertakings commenced in FY2010 yielded significant improvements to its generation plants up to current.



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In addition to upgrades and expansion efforts, PPUC management is cognizant of the high cost of maintenance which impacts its customers and, therefore, is undertaking proactive efforts to control and minimize such costs. In 2013, PPUC management successfully negotiated an informal purchase arrangement directly with a manufacturer for supply of maintenance parts for the two 5MW units in Malakal resulting in material savings of about half a million dollars. Further, PUC terminated an Operations & Maintenance Contract with a contractor for their failure to provide sound technical advice and an inferior maintenance program. Streamlining purchases, thus, eliminating unnecessary middlemen and cost will be pursued on future orders. PPUC management will strive to ensure full return on monies spent.

On November 5, 2011, PPUC suffered an unfortunate fire to its Aimeliik Power Plant, effectively decommissioning all four Pielstick generators, a combined generation capacity of 8MW. This forced power rationing and brown-outs for a brief period of two months. In collaboration with the national government, PPUC was able to purchase and install a brand new 2MW CAT generator at the plant to augment power supply, until repair work concluded on the main baseload units installed at Malakal. Loss suffered from the fire exceeded \$1.2M.

Water and Wastewater Operations:

PPUC, through the Merger Act, has undertaken management of a water and sewer system that dates back to 1987. Significant and material improvements are needed to upgrade the systems' capacity to accommodate the domestic and commercial growth since then plus anticipated growth in the near future. Substantial efforts had preceded the merger that secured long-term soft-loans through the Asian Development Bank (ADB) to finance some improvements to the water system and capacity-expansion for the sewer systems of the two densely populated cities of Koror and Airai (roughly \$28M). PPUC continues to pursue potential funding sources to meet its mission respective of water and sewer needs, the accomplishment of which should enable PPUC to operate under a commercially viable framework.

The prime objective of PPUC-Water and Wastewater Operations (WWO) as mandated by the law is that full cost recovery is achieved. To achieve this, PPUC intends to charge customers for the full cost of services provided, including cost of capital to PPUC-WWO. PPUC-WWO has inherited a number of rural services (Outlying States) that would not be provided if it were to purely pursue its objective of corporate sustainability. To continue to provide these services would require the corporation to charge other (Koror/Airai) customers a premium in addition to the true cost of services, which would represent a subsidy to these services. The cost to provide services to the Outlying States represent a commitment by former governments to universal access to water and wastewater service and a provision in RPPL No. 9-4 prohibiting tariff adjustments specifically for the Outlying States.

Major water systems improvement projects identified as priority CIP commenced in 2013 and progressed well into 2014. The 17 outlying states water systems assessment was completed in 2014 and the estimated cost to upgrade these systems is well over \$2.5 million. A grant from SPC to improve water systems in the three southern-most islands of Tobi, Sonsorol and Pulo Anna commenced in 2014.

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In FY2014, PPUC secured two long term soft loans from ADB through the ROP for Koror-Airai Sanitation Project (KASP). This project is expected to address the impact of the economy, health and environmental issues caused by the degraded wastewater facilities and limited capacity of the Koror sewerage network, and unsuitable soils for septic tanks in Airai. KASP required PPUC to recruit a Project Implementation Agency Consultant (PIAC). An invitation for expression of interest was posted on ADB's consulting services websites. Six (6) firms were short-listed at the KASP meeting and RFP's were issued to the short-listed firms. Technical and Financial proposals were received from 3 firms. Final ranking of proposals using a quality-cost ratio of 90:10 was completed in August 2014. PPUC and ADB negotiated with the first ranked consultant, a contract was ratified by the PPUC Board of Directors and Egis Eau in September 2014. The KASP project commenced in October 2014 and is expected to be completed and commissioned in September 2018.

The average daily water production from the Koror-Airai Water Treatment Plant (KAWTP) is 3.2 million gallons. The water treatment plant services more than 80% of the population. The Non-Revenue Water (NRW) is approximately 48% of the daily water production and it is expected to be reduced in subsequent years from the outcome of the metering program and on-going leak detection program.

FINANCIAL HIGHLIGHTS

The following summarizes PPUC's combined financial position and revenues, expenses, and changes in net position during the year.

Table 1
(Dollars in Thousands)

	Sept 30, 2014	Sept 30, 2013	Sept 30, 2012	Inc (Dec) 2014	Inc (Dec) 2013
Statements of Net Position					
Current Assets	\$ 21,315	\$ 19,273	\$ 16,682	\$ 2,042	\$ 2,591
Other Assets	207	271	228	(64)	43
Net Utility Plant	52,168	41,149	26,620	11,019	14,529
Total Assets	73,690	60,693	43,530	12,997	17,163
Current Liabilities	8,919	7,480	7,502	1,439	(22)
Other Liabilities	6,993	7,541	8,079	(548)	(538)
Total Liabilities	15,912	15,021	15,581	891	(560)
Net Investment in Capital Assets	47,226	35,879	20,996	11,347	14,883
Unrestricted	10,552	9,793	6,953	759	2,840
Total Net Position	\$ 57,778	\$ 45,672	\$ 27,949	\$ 12,106	\$ 17,723

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Table 1. Continued
(Dollars in Thousands)

	Sept 30, 2014	Sept 30, 2013	Sept 30, 2012	Inc (Dec) 2014	Inc (Dec) 2013
Revenues, Expenses, and Changes in Net Position					
Operating Revenues:					
Electric	\$ 24,925	\$ 25,597	\$ 25,238	\$ (672)	\$ 359
Water	1,566	247	-	1,319	247
Wastewater	636	127	-	509	127
Others	672	643	609	29	34
Provision for bad debts	(313)	(60)	(208)	(253)	148
Nonoperating revenue (expense)	1,988	1,546	(718)	442	2,264
Net Revenue	29,474	28,100	24,921	1,374	3,179
Operating Expenses:					
Generation fuel	18,732	18,828	18,974	(96)	(146)
Generation other costs	3,473	2,949	3,083	524	(134)
Depreciation	3,953	2,245	1,758	1,708	487
Administration	1,642	1,159	1,154	483	5
Distribution and transmission	787	714	923	73	(209)
Engineering services	542	315	200	227	115
Renewable energy	86	106	100	(20)	6
Water operations	1,833	675	-	1,158	675
Wastewater operations	508	438	-	70	438
Total Operating Expenses	31,556	27,429	26,192	4,127	1,237
Capital contributions	14,188	3,433	2,109	10,755	1,324
Special Item: Net value of assets transferred	-	13,619	-	(13,619)	13,619
Extraordinary Item: Loss from fire	-	-	(1,208)	-	1,208
Change in Net Position	12,106	17,723	(370)	(5,617)	18,093
Beginning Net Position	45,672	27,949	28,319	17,723	(370)
Ending Net Position	\$ 57,778	\$ 45,672	\$ 27,949	\$ 12,106	\$ 17,723

Various factors contributed to current year's net change to Net Position as follows:

1. Revenues and expenses reflect twelve months of water and wastewater operations.
2. A stabilized fuel market as indicated in the fuel price graph presented under Economic Factors and Outlook has kept fuel costs down.
3. Capital contributions from a donor country (Japan) for the new power plant, valued at \$15M, became operational in May FY2014.
4. Capital improvement projects for Melekeok and Koror sewer upgrade. In addition, PPUC received about \$1.7M of operating subsidies from the ROP for the Water and Wastewater Operations.

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In order to better perceive significant changes during the year, if any, a three-year presentation of the financial position and revenues, expenses and changes in net position for each of the utility's operations are presented below in Tables 2 and 3:

Table 2: Electric Power Operation
(Dollars in Thousands)

	Sept 30, 2014	Sept 30, 2013	Sept 30, 2012	Inc (Dec) 2014	Inc (Dec) 2013
Statements of Net Position					
Current Assets	\$ 20,417	\$ 17,017	\$ 16,682	\$ 3,400	\$ 335
Other Assets	203	271	228	(68)	43
Net Utility Plant	39,858	28,888	26,620	10,970	2,268
Total Assets	60,478	46,176	43,530	14,302	2,646
Current Liabilities	7,974	7,257	7,502	717	(245)
Other Liabilities	6,994	7,541	8,079	(547)	(538)
Total Liabilities	14,968	14,798	15,581	170	(783)
Net Investment in Capital Assets	34,916	23,617	20,996	11,299	2,621
Unrestricted	10,594	7,761	6,953	2,833	808
Total Net Position	\$ 45,510	\$ 31,378	\$ 27,949	\$ 14,132	\$ 3,429
Revenues, Expenses, and Changes in Net Position					
Operating Revenues:					
Electric	\$ 27,308	\$ 26,360	\$ 25,238	\$ 948	\$ 1,122
Others	634	643	609	(9)	34
Provision for bad debts	(292)	(60)	(208)	(232)	148
Nonoperating revenue (expense)	152	(1,127)	(718)	1,279	(409)
Net Revenue	27,802	25,816	24,921	1,986	895
Operating Expenses:					
Generation fuel	18,732	18,828	18,974	(96)	(146)
Generation other costs	3,503	2,950	3,083	553	(133)
Depreciation	2,187	1,803	1,758	384	45
Administration	920	1,095	1,154	(175)	(59)
Distribution and transmission	813	723	923	90	(200)
Engineering services	554	315	200	239	115
Renewable energy	92	106	100	(14)	6
Total Operating Expenses	26,801	25,820	26,192	981	(372)
Capital Contributions	13,131	3,433	2,109	9,698	1,324
Extraordinary Item: Loss from fire	-	-	(1,208)	-	1,208
Change in Net Position	14,132	3,429	(370)	10,703	3,799
Beginning Net Position	31,378	27,949	28,319	3,429	(370)
Ending Net Position	\$ 45,510	\$ 31,378	\$ 27,949	\$ 14,132	\$ 3,429

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Changes to utility plant asset are discussed below under Capital Assets and Long-Term Debt.

A slight electric sales increase is attributed to rate changes implemented through the newly adopted tariff schedule with an impact on a reduced price of fuel and a strengthened effort of public relation office conservation programs. This also could be a direct result of the six (6) percent reduction of water and wastewater electric bill compared to last year. Capital contributions are grants from Japan in FY2014 and FY2013 for the construction of a new power plant at Aimeliik equipped with two new 5MW base load generators and acquisition of 4 smaller backup units in FY2012. The extraordinary loss in FY2012 was the value of assets damaged by a fire in November 2011.

Table 3: Water and Wastewater Operation
(Dollars in Thousands)

	Sept 30, 2014	Sept 30, 2013	Inc (Dec) 2014	Inc (Dec) 2013
Statements of Net Position				
Current Assets	\$ 2,019	\$ 3,035	\$ (1,016)	\$ 3,035
Other Assets	4	-	4	-
Net Utility Plant	12,310	12,261	49	12,261
Total Assets	14,333	15,296	(963)	15,296
Current Liabilities	2,065	1,002	1,063	1,002
Total Liabilities	2,065	1,002	1,063	1,002
Net Investment in Capital Assets	12,310	12,262	48	12,262
Unrestricted	(42)	2,032	(2,074)	2,032
Total Net Position	\$ 12,268	\$ 14,294	\$ (2,026)	\$ 14,294
Revenues, Expenses, and Changes in Net Position				
Operating Revenues:				
Water	\$ 1,603	\$ 384	\$ 1,219	384
Wastewater	636	-	636	-
Others	38	-	38	-
Provision for bad debts	(21)	-	(21)	-
Nonoperating revenue (expense)	1,836	2,673	(837)	2,673
Net Revenue	4,092	3,057	1,035	3,057
Operating Expenses:				
Water operations	3,656	1,438	2,218	1,438
Wastewater operations	981	438	543	438
Depreciation	1,766	442	1,324	442
Administration	771	65	707	65
Total Operating Expenses	7,175	2,383	4,792	2,383
Special Item: Net value of assets transferred	-	13,620	(13,620)	13,620
Capital Contributions	1,057	-	1,057	-
Change in Net Position	(2,026)	14,294	(16,320)	14,294
Beginning Net Position	14,294	-	14,294	-
Ending Net Position	\$ 12,268	\$ 14,294	\$ (2,026)	\$ 14,294

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Assets and liabilities transferred were agreed to between ROP and PPUC with the effective date of July 1, 2013. Thus, 2013 numbers reflect three months of operations from July 1 through September 30, 2013. ROP had appropriated funds for the start-up of the newly formed PWSC. The unexpended fund from this appropriation was transferred to PPUC. Significant cost components of the Water & Wastewater operating expenses are (in approximate percentages): electricity/water (34%), personnel (29%), depreciation (24%) and water chemicals (7%).

CAPITAL ASSETS and LONG-TERM DEBT

Capital Assets

PPUC realized a significant capital injection in 2014 in electric plants from a grant provided by a donor country (Japan) for four back-up generator units. Other smaller investments were made during the year to augment or replace aging equipment or structures. At the end of FY2014, PPUC had invested in a broad range of utility capital assets, including its power generation plants, electric, water and wastewater transmission and distribution infrastructures, and general support and administrative equipment. PPUC's investment in capital assets increased by \$11M to \$52.2M at the end of this fiscal year, inclusive of the new Aimeliik Power Plant that became operational in May, 2014, net of depreciation. Refer below for details of this year's activities.

The following table summarizes PPUC's capital assets by category and accumulated depreciation, and the changes therein for the years ended September 30, 2014, 2013, and 2012, respectively.

CAPITAL ASSETS AND ACCUMULATED DEPRECIATION
(Dollars in Thousands)

	Sept 30, 2014	Sept 30, 2013	Sept 30, 2012	Increase (Decrease) 2014	Increase (Decrease) 2013
CAPITAL ASSETS:					
Electric Plants:					
Electric Plants, Koror/Aimeliik	\$ 41,123	\$ 26,513	\$ 28,340	\$ 14,610	\$ (1,827)
Electric Plants, Outlying States	2,626	2,605	2,378	21	227
Total Electric Plants	43,749	29,118	30,718	14,631	(1,600)
Accumulated Depreciation	(15,127)	(13,784)	(17,951)	(1,343)	4,167
Net Electric Plant	28,622	15,334	12,767	13,288	2,567
Transmission & Distribution (T&D) System:					
T&D System, Koror/Aimeliik	17,512	17,424	17,263	88	161
T&D System, Outlying States	2,090	2,090	2,090	-	-
Total T&D System	19,602	19,514	19,353	88	161
Accumulated Depreciation	(10,465)	(9,887)	(9,325)	(578)	(562)
Net T&D System	9,137	9,627	10,028	(490)	(401)
Water & Sewer Systems:					
Water Infrastructure	21,461	21,397	-	64	21,397
Sewer Infrastructure	20,129	19,407	-	722	19,407
Total Water & Sewer Systems	41,590	40,804	-	786	40,804
Accumulated Depreciation	(30,341)	(28,640)	-	(1,701)	(28,640)
Net Water & Sewer Systems	11,249	12,164	-	(915)	12,164

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CAPITAL ASSETS AND ACCUMULATED DEPRECIATION, CONTINUED
(Dollars in Thousands)

CAPITAL ASSETS:	Sept 30, 2014	Sept 30, 2013	Sept 30, 2012	Increase (Decrease) 2014	Increase (Decrease) 2013
Water & Sewer Transmission & Distribution System:					
WVO T&D System, Koror/Babeldao	\$ 318	\$ -	\$ -	\$ 318	\$ -
Total WVO T&D System	318	-	-	318	-
Accumulated Depreciation	-	-	-	-	-
Net WVO T&D System	318	-	-	318	-
Administrative Equipment:					
Buildings	1,749	1,576	1,424	173	152
Heavy Equipment & Vehicles	2,020	1,634	1,546	386	88
Tools & Maint Equipment	1,001	936	882	65	54
Computers & Office Equipment	870	755	644	115	111
Total Admin Equipment	5,640	4,901	4,496	739	405
Accumulated Depreciation	(3,375)	(3,044)	(2,868)	(331)	(176)
Net Admin Equipment	2,265	1,857	1,628	408	229
Capital Improvement Projects:					
500KW Mitsubishi Generators (4)	-	-	2,109	-	(2,109)
APP New Power Plant Groundworks	-	2,167	88	(2,167)	2,079
2MW CAT Generator	577	-	-	577	-
Total Capital Projects in Progress	577	2,167	2,197	(1,590)	(30)
TOTAL FIXED ASSETS	\$ 52,168	\$ 41,149	\$ 26,620	\$ 11,019	\$ 14,529

The following major Capital Improvement Projects were completed during the year:

EPO:

- Feasibility study of existing SCADA System \$ 68,215
- APP New Power Plant \$ 13,145,755
- New Power Plant Ground Clearing \$ 175,962

WVO:

- Metering Program \$ 275,516
- Koror and Melekeok Sewer Upgrade \$ 1,056,993

Ongoing Capital Improvement Projects are:

- EPO APP Tank Farm \$ 143,600
- EPO APP New Panel Board \$ 38,300
- WVO WTP Filter Repair \$ 263,200
- WVO High Service Pressure Pump Replacement \$ 284,573
- WVO Vehicle Replacement Project \$ 39,085

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PPUC's capital improvement plans are based, in principle, on the master plan developed for PPUC in FY2009. The master plan identifies forward-looking strategies based on externally developed assumptions about PPUC's demographics and customer demands up to year 2025. The plan includes construction of a new power plant at Aimeliik with installation of six 5MW generators staggered every two years. The plan has been modified internally to include only the first two 5MW units, deferring the remaining units until an updated study can be made of energy demand and renewable energy plans.

EPO is continuing its efforts to augment generation with alternative renewable energy. A new 225KW PV system was installed and commenced operation in October 2011, at the Palau International Airport parking lot. Transfer of ownership is pending execution of a Memorandum of Understanding with an affiliate that was the official grant recipient. With this acquisition plus existing third party renewable energy systems connected to the PPUC grid, total RE generation capacity total 377KW. Further studies and plans are underway for possible additional solar, wind and hydro systems for the main power grid, and hybrid systems for the Outlying States.

WWO continues to implement capital improvement projects with subsidies from the government. Projects were prioritized to commence with the water sector improvement project fund. A design-build high-service pumps replacement project for KAWTP to supply the most cost efficient pump and motor combination is on-going and is expected to reduce the annual electric bill by over 20%.

Please see note 7 to the financial statements for additional information regarding PPUC's capital assets.

Long-Term Debt

At September 30, 2014, PPUC's loan portfolio comprised the following:

	Original	Sept 30, 2014
International Loan	\$ 7,000,000	\$ 5,000,000
Local Loan	\$ 3,000,000	\$ 2,541,129
TOTAL	\$ 10,000,000	\$ 7,541,129

The above debt are acquired to purchase additional generation capacity and to finance major repairs and generation auxiliary equipment. The long-term soft loans secured by ROP from Asian Development Bank were subsequently loaned to PPUC as per subsidiary loan agreements dated March 28, 2014. Proceeds will be used to upgrade the Koror sewerage system and construct a wastewater treatment plant and sewerage network in Airai. PPUC will record the loan amounts when the loan proceeds withdrawal application is approved by ADB and disbursed directly to the contractors. Please see note 8 to the financial statements for additional information regarding PPUC's long-term debt.

PALAU PUBLIC UTILITIES CORPORATION
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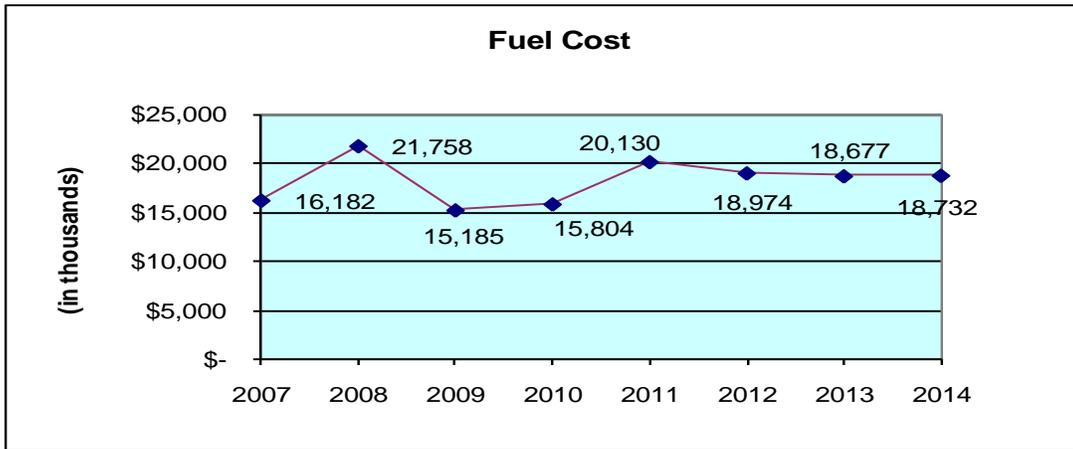
Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

ECONOMIC FACTORS and OUTLOOK

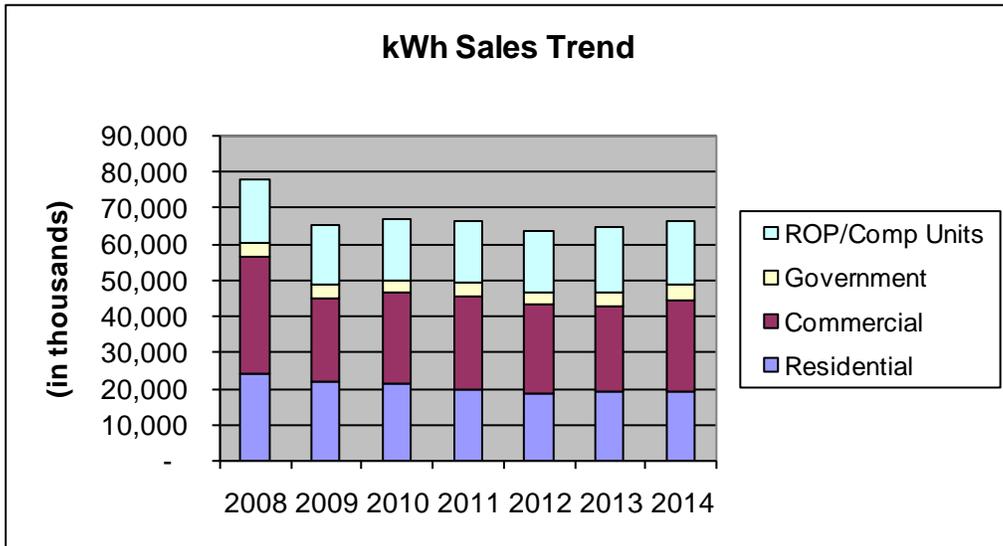
Fuel Market

Fuel costs make up over 70% of PPUC's operating costs. Due to size and location, PPUC's dependence on fossil fuel is likely to continue for several years and price volatility will continue to be a germane factor in PPUC's power supply scenario. PPUC's vulnerability is clear and efforts will continue to try and contain this risk.

The cost trend of fuel for the past three years is steady (see chart below). The trend of fuel cost from 2008 to 2011 highlights the volatility of the market and PPUC's exposure.



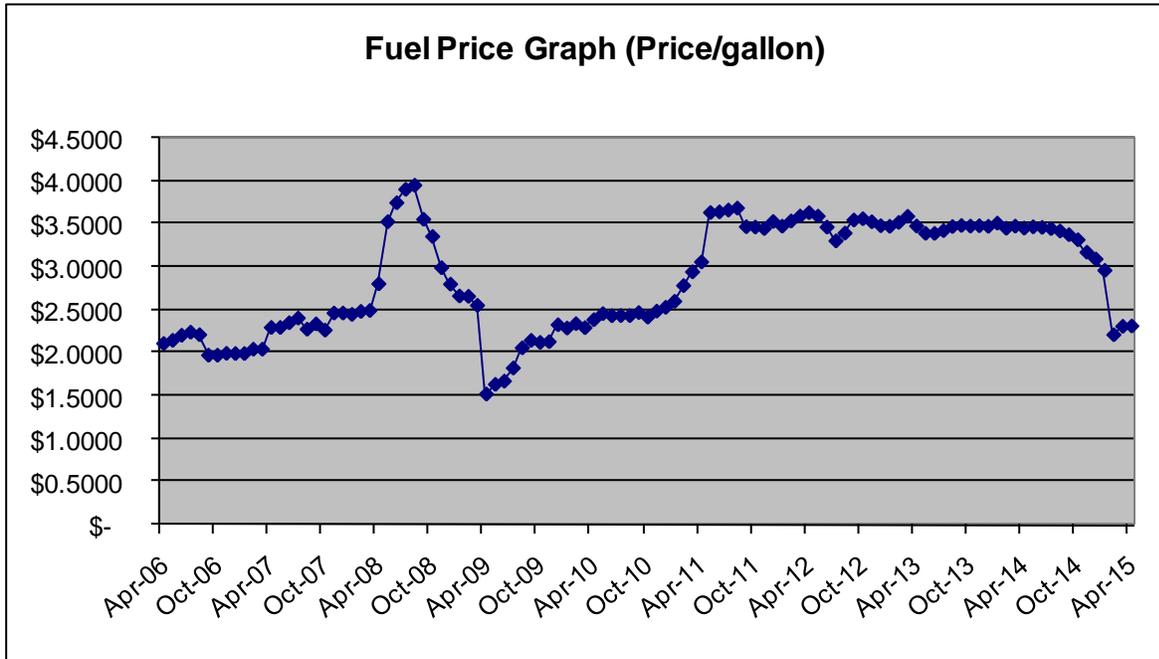
Fuel impact is evident in our sales performance. The steep price spike in the fuel market in 2008 provoked unforeseen energy conservation efforts carried through 2011. Steady sales through 2011 was disrupted by a 4% drop in consumption, apparently a reaction to resurgence of price escalation in 2011, which impelled further conservation measures. The chart below illustrates this impact on sales performance.



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Various factors drive gas/oil prices. Tensions in the Middle East and economic outlook of demand are contributing factors. These factors are unpredictable and erratic as seen in the graph below.



Unpredictability and volatility of the fuel market gives impetus to the drive for stable and controlled electric cost. Combined with global temperament towards environmental issues, these are making renewable energy a relevant, if not a significant, energy source in the future. PPUC is continuing its efforts, aided by development partners, to diversify its energy source and reduce dependence on fossil fuel.

Another dynamic on the energy scene in Palau is PPUC customers making entry into RE platforms in an effort to protect themselves from risks in the fossil fuel market. To date, total photovoltaic systems installed at various establishments add up to approximately 1% of PPUC's total generation capacity, at KWp. Furthermore, various hotels have made significant investment in solar water heaters, reducing power consumption. This scenario reveals the energy market in Palau is becoming increasingly competitive.

Water & Wastewater Operation

On June 6, 2013, a bill was signed into law that consolidated the two independent public corporations, the PWSC and the PUC, under one corporate identity, the Palau Public Utilities Corporation. The intent of the Consolidation Act was to realize cost savings through synergies of administrative processes.

A one year old corporation merged with EPO and faced with common challenges of rising material costs, aging infrastructure, regulatory challenges, ensuring adequate long-term water supply, health and environmental issues, rate structure under stress from subsidy reduction and cultural resistance to change, workforce complexities, and other barriers are just some of the attributes that the Board and Management have in mind when developing strategic directions.

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Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

A significant operating cost of Water & Wastewater Operations is electricity for water and sewer pumps. This makes up roughly 34% of operating expenses. This cost is dependent on factors discussed above.

Palau is naturally blessed with rich water resources. PPUC's task is to harness, store and safeguard such resource to meet Palau's growing needs. Upgrade of systems and storage capacity, and efficient distribution together with effective monitoring and safeguarding mechanisms are challenges that management is actively pursuing with the support of Palau's leadership and donor partners.

FUTURE OUTLOOK

PPUC-EPO will continue to exert efforts towards the NEP targets of 30/20/20 (30% reduction of overall energy consumption and 20% renewable energy platforms by the year 2020). Renewable energy continues to attract development partners sympathetic to global warming issues. PPUC's efforts should focus on energy diversification and generation upgrades to assure energy supply stability and to benefit from cutting-edge technological advances.

Palau's economic outlook appears fair. Our tourism market appears to be stable based on visitor arrival statistics provided by the Palau Visitors Authority. Management is optimistic of a potentially robust economy and a commercially viable environment for the future.

PPUC-WWOs continues its effort to ensure sufficient water supply, water quality, access to water supply and sanitation. This strengthened effort is mandated by the leadership to meet service demands from the rapidly growing number of visitors each year.

ROP is re-negotiating new terms for a new Compact of Free Association (COFA) with the United States of America. Renewed COFA terms will assure the national government, and the local economy, of steady capital inflow to sustain current and spur new economic initiatives. This is a positive indicator as the national government is the single largest employer on island as well as a major player in Palau's economy.

CONTACTING PPUC'S FINANCIAL MANAGEMENT

This financial report is designed to provide PPUC's rate payers and creditors with a general overview of PPUC's finances and to demonstrate PPUC's accountability for the money it receives. Management's Discussion and Analysis for the year ended September 30, 2013 is set forth in PPUC's report on the audit of financial statements which is dated June 30, 2014.

If you have questions about this report, or need additional information, contact the PPUC Accounting Department at the Palau Public Utilities Corporation, P.O. Box 1372, Koror, Republic of Palau 96940, or e-mail cfo@ppuc.com or call 488-5320.

PALAU PUBLIC UTILITIES CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Utility plant:		
Depreciable utility plant	\$ 51,590,347	\$ 38,982,276
Non-depreciable utility plant	577,349	2,166,962
Net utility plant	<u>52,167,696</u>	<u>41,149,238</u>
Current assets:		
Cash and cash equivalents	8,439,100	3,902,739
Receivables:		
Trade	3,376,320	3,316,119
Affiliate	1,058,987	3,050,850
Contracts	121,411	121,241
Other	102,336	69,294
	<u>4,659,054</u>	<u>6,557,504</u>
Less allowance for doubtful accounts	<u>(647,000)</u>	<u>(471,000)</u>
Net receivables	<u>4,012,054</u>	<u>6,086,504</u>
Prepaid expenses	246,235	691,016
Inventory, net	8,500,075	8,509,267
Due from grantor agencies	118,000	83,071
Total current assets	<u>21,315,464</u>	<u>19,272,597</u>
Other non-current assets:		
Contracts receivable, net of current portion	<u>207,415</u>	<u>271,092</u>
	<u>\$ 73,690,575</u>	<u>\$ 60,692,927</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Net position:		
Net investment in capital assets	\$ 47,226,567	\$ 35,878,693
Unrestricted	<u>10,551,639</u>	<u>9,793,331</u>
Total net position	<u>57,778,206</u>	<u>45,672,024</u>
Commitments and contingencies		
Current liabilities:		
Current portion of long-term debt	548,183	537,508
Accounts payable	6,795,747	6,115,432
Accrued expenses	1,101,598	376,396
Customer deposits	473,895	450,529
Total current liabilities	<u>8,919,423</u>	<u>7,479,865</u>
Long-term debt, net of current portion	<u>6,992,946</u>	<u>7,541,038</u>
Total liabilities	<u>15,912,369</u>	<u>15,020,903</u>
	<u>\$ 73,690,575</u>	<u>\$ 60,692,927</u>

See accompanying notes to financial statements.

PALAU PUBLIC UTILITIES CORPORATION
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating revenues:		
Power	\$ 24,924,541	\$ 25,597,453
Water	1,566,210	246,977
Wastewater	636,098	126,768
Other	672,332	642,914
Total operating revenues	27,799,181	26,614,112
Provision for uncollectible receivables	(312,855)	(60,353)
Net operating revenues	27,486,326	26,553,759
Operating expenses:		
Generation - fuel	18,732,306	18,828,586
Depreciation	3,953,456	2,244,591
Generation - other cost	3,472,728	2,949,287
Administration	1,642,143	1,158,990
Distribution and transmission	787,352	714,051
Engineering services	541,542	314,560
Renewable energy	85,516	106,151
Water operations	1,833,491	674,847
Wastewater operations	507,995	438,180
Total operating expenses	31,556,529	27,429,243
Operating loss	(4,070,203)	(875,484)
Nonoperating revenues (expenses):		
Operating subsidies from the Republic of Palau	1,800,729	2,672,734
Grants from the Japan Government	266,203	-
Grants from the United States Government	45,000	345,258
Interest income	1,416	538
Gain on disposal of assets	-	250
Writedown of generators	-	(200,000)
Writedown of generation parts and supplies inventory	-	(870,000)
Interest expense	(383,207)	(404,185)
Other	258,043	1,440
Total nonoperating revenues (expenses), net	1,988,184	1,546,035
(Loss) earnings before capital contributions and special item	(2,082,019)	670,551
Capital contributions:		
Donated capital from the Republic of Palau	1,056,993	-
Grants from the Japan Government	13,131,208	3,432,642
Special item:		
Transfer of water and wastewater operations at carrying value	-	13,619,437
Change in net position	12,106,182	17,722,630
Net position at beginning of year	45,672,024	27,949,394
Net position at end of year	\$ 57,778,206	\$ 45,672,024

See accompanying notes to financial statements.

PALAU PUBLIC UTILITIES CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	\$ 29,647,818	\$ 26,614,392
Cash payments to suppliers for goods and services	(22,408,825)	(23,242,758)
Cash payments to employees for services	(3,333,571)	(2,695,262)
Net cash provided by operating activities	3,905,422	676,372
Cash flows from investing activities:		
Net change in restricted cash	-	124,844
Interest on investments	1,416	538
Other non-operating	61,508	1,440
Net cash provided by investing activities	62,924	126,822
Cash flows from non-capital financing activities:		
Appropriations received from the Republic of Palau	1,800,729	1,288,390
Cash received from grantor agencies	472,809	262,187
Net cash provided by non-capital financing activities	2,273,538	1,550,577
Cash flows from capital and related financing activities:		
Principal payment on long-term debt	(537,417)	(527,502)
Interest paid on long-term debt	(384,393)	(346,606)
Acquisition of utility plant	(783,713)	(1,279,474)
Net cash used for capital and related financing activities	(1,705,523)	(2,153,582)
Net change in cash and cash equivalents	4,536,361	200,189
Cash and cash equivalents at beginning of year	3,902,739	3,702,550
Cash and cash equivalents at end of year	\$ 8,439,100	\$ 3,902,739
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (4,070,203)	\$ (875,484)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	3,953,456	2,244,591
Provision for uncollectible receivables	312,855	60,353
(Increase) decrease in assets:		
Receivables:		
Trade	(197,056)	(238,416)
Affiliate	1,991,863	343,733
Contracts	63,507	(61,293)
Other	(33,042)	(37,608)
Prepaid expenses	444,781	7,565
Inventory	9,192	(584,547)
Increase (decrease) in liabilities:		
Accounts payable	680,315	(146,358)
Accrued expenses	726,388	(30,028)
Customer deposits	23,366	(6,136)
Net cash provided by operating activities	\$ 3,905,422	\$ 676,372

Non-cash transactions:

In 2014 and 2013, PPUC received \$13,131,208 and \$3,432,642, respectively, in grants from the Japan Government consisting of various utility plant equipment and related costs of installation.

In 2014, ROP transferred sewer assets to PPUC with a total cost of \$1,056,993.

In 2013, as a result of the transfer of the water and wastewater operations, PPUC received various assets and liabilities with net carrying value of \$12,920,808.

PALAU PUBLIC UTILITIES CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2014 and 2013

(1) Organization

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

On June 6, 2013, RPPL 9-4 was signed into law for the purpose of merging the Palau Water & Sewer Corporation and PUC operations as Palau Public Utilities Corporation (PPUC). The electric power operations (EPO) and water and wastewater operations (WWO) are to be treated as separate business segments having their own organizational chart delineating its chain of management. Further, shared administrative costs and expertise are to be allocated between EPO and WWO and shall not be utilized to subsidize each other.

On July 16, 2013, a memorandum of understanding was agreed by PPUC and the ROP Ministry of Finance (ROP-MOF) to delineate certain arrangements and conditions under which ROP-MOF shall provide accounting processing services to WWO while it is being established as a business segment of PPUC accounting systems. On February 24, 2014, PPUC and ROP-MOF formalized the transfer of all assets and liabilities of WWO and established the effective date of transfer to be July 1, 2013. While the law effected a merger date of June 6, 2013, PPUC and ROP-MOF agreed that intervening transactions in between that date to July 1, 2013 were not material to the financial statements.

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

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accounting policies of PPUC conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. PPUC 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.

Accounting Estimates

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

PALAU PUBLIC UTILITIES CORPORATION
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and time certificates of deposit with original maturities of three months or less.

Receivables

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

Inventory

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

Utility Plant

Utility plant purchased or constructed is stated at cost. Donated utility plant is recorded at fair market value at the date of donation or at the donating entity's basis in the asset if donated by ROP or an ROP agency. PPUC capitalizes utility plant with a cost of \$500 or more.

Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

PPUC capitalizes interest in order to recognize all costs associated with construction based on PPUC's weighted average borrowing rate. No interest was capitalized during the years ended September 30, 2014 and 2013.

Net Position

Net position represents the residual interest in PPUC's assets after liabilities are deducted and consist of four sections:

Net investment in capital assets – include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve.

Restricted expendable – net position whose use is subject to externally imposed stipulations that can be fulfilled by actions of PPUC pursuant to those stipulations or that expire with the passage of time.

Restricted nonexpendable – net position subject to externally imposed stipulations that require PPUC to maintain them permanently.

Unrestricted – net position that 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.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Sales of Electricity

Sales of electricity, water and wastewater services are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing. Unbilled revenues at September 30, 2014 and 2013 were \$1,922,946 and \$1,765,962, respectively.

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses include all direct and administrative revenues and expenses associated with the generation and distribution of electricity and water and the provision of wastewater services to customers in the ROP.

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

Retirement Plan

PPUC 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 provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau, Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. On April 30, 2013, RPPL 9-2 was enacted which eliminates the mandatory service retirement after thirty years of service. After December 31, 2013, no employee shall be entitled to pension benefits until reaching the age of sixty. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer. PPUC contributed \$183,459, \$122,322 and \$102,092 to the Fund during the fiscal years 2014, 2013 and 2012, respectively, which was equal to the required contributions for the respective years then ended.

Under the provisions of RPPL 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation Plan which has the force and effect of law and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. PPUC's total payroll, except expatriate workers, for fiscal years 2014 and 2013 is covered by the Fund's plan.

The Fund utilizes the actuarial cost method termed "level aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 7.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement, and (c) members are assumed to retire at their normal retirement date.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan, Continued

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

The Fund's October 1, 2013 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	\$ 82,099,216
Active participants	61,865,857
Participants with vested deferred benefits	<u>3,323,468</u>
Total pension benefit obligation	147,288,541
Net assets available for benefits, at market value	<u>(34,261,206)</u>
Unfunded benefit obligation	\$ <u>113,027,335</u>

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net position available for benefits by sponsor. The amount of the unfunded liability that PPUC may be liable for has not been determined and is not included as a liability in the accompanying statements of net position.

The Fund issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained by writing to the Republic of Palau Civil Service Pension Plan, P.O. Box 1767, Koror, Palau 96940.

Compensated Absences

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

Taxes

Based on enactment of RPPL 4-13 and RPPL 9-4, PPUC is exempt from all national and state non-payroll taxes or fees.

New Accounting Standards

During the year ended September 30, 2014, PPUC implemented the following pronouncements:

- GASB Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The implementation of this statement did not have a material effect on the accompanying financial statements.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Statement 68 will require PPUC to recognize a net pension liability based on the percentage of the actuarial present value of projected benefit payments allocated to PPUC by the Palau Civil Service Trust Fund (the Fund). The Fund has not communicated amounts to PPUC which may be material and will be recorded on October 1, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of PPUC.

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

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of PPUC.

Reclassifications

Certain reclassifications have been made to the 2013 financial statements to correspond to the 2014 presentation.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(3) Cash and Cash Equivalents

Custodial credit risk is the risk that in the event of a bank failure, PPUC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. PPUC does not have a deposit policy for custodial credit risk.

As of September 30, 2014 and 2013, cash and cash equivalents were \$8,439,100 and \$3,902,739, respectively, and the corresponding bank balances were \$8,439,174 and \$3,977,635, respectively. Of these amounts, \$8,066,498 and \$3,604,846, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance; while \$372,676 and \$372,789 as of September 30, 2014 and 2013, respectively, are held and administered by investment managers subject to Securities Investor Protection Corporation Insurance. As of September 30, 2014 and 2013, bank deposits of \$750,000 and \$618,732, respectively, were FDIC insured. PPUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage and deposits in financial institutions not subject to FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

(4) Grants

U.S. Federal Government:

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

Japan Government:

On March 2, 2012, the Japan Government awarded emergency grant aid of up to 300,000,000 yen, or approximately \$3,000,000 at the date of award, for the purpose of contributing to the implementation of an emergency measure against a power crisis in November 2011. On March 5, 2012, PPUC entered into an agent agreement (the Agreement) with Japan International Cooperation System, a Japan non-for-profit organization in charge of procurement services in Grant Aid and Technical Cooperation, to be its procurement agent as a requirement of the grant. Proceeds from the grant were used to fund utility plant related projects (see note 7).

On June 27, 2012, the Japan Government provided a grant for the Enhancing Power Generation Capacity in the Urban Area in the Republic of Palau (the Project) for 1,729,000,000 yen or approximately \$21,700,000 at the date of award. The Project involves the rebuilding of the Aimeliik power plant. As part of the grant, PPUC entered into an agreement with a consultant on July 16, 2012 to provide professional services for design, assistance of tendering, and supervision of the Project and with a contractor on November 26, 2012 for the construction of the new Aimeliik power plant.

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(4) Grants, Continued

Changes in the due from U.S. Federal and Japan Governments' grants for the years ended September 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Balance at beginning of year	\$ 79,471	\$ -
Additions - program outlays:		
U.S. Federal Government	45,000	345,258
Japan Government	<u>13,397,411</u>	<u>3,432,642</u>
	<u>13,521,882</u>	<u>3,777,900</u>
Deductions:		
Cash receipts from the U.S. Federal Government	(124,471)	(265,787)
Noncapital costs from the Japan Government grants	(266,203)	-
Capitalized cost from the Japan Government grants	<u>(13,131,208)</u>	<u>(3,432,642)</u>
	<u>(13,521,882)</u>	<u>(3,698,429)</u>
Balance at end of year	\$ <u> -</u>	\$ <u>79,471</u>

(5) Receivable from a Local Bank

At September 30, 2014 and 2013, PPUC has uninsured deposits of \$2,025,381 with a bank that went into receivership on November 7, 2006. These deposits were fully provided for with an allowance at September 30, 2014 and 2013.

(6) Inventory

Inventory at September 30, 2014 and 2013, consists of the following:

	<u>2014</u>	<u>2013</u>
Generation parts and supplies	\$ 5,709,597	\$ 5,946,838
Fuel	3,741,505	3,358,689
Lubricants	30,991	31,132
Chemicals	85,161	253,436
Water distribution parts and supplies	<u>34,487</u>	<u>20,838</u>
	9,601,741	9,610,933
Provision for slow moving and obsolete inventory	<u>(1,101,666)</u>	<u>(1,101,666)</u>
	<u>\$ 8,500,075</u>	<u>\$ 8,509,267</u>

Generation parts and supplies inventory included \$717,000 of spare parts and maintenance tools for the new Aimeliik power plant included in the Japan Government grant (see note 4).

Provision for slow moving and obsolete inventory of \$870,000 at September 30, 2014 and 2013 was provided for generation parts and supplies inventory that are maintained in the Aimeliik power plant that caught fire in November 2011.

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(7) Utility Plant

Utility plant consists of the following detailed balances at September 30, 2014 and 2013:

	Estimated Useful Lives	Balance at October 1, 2013	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2014
Depreciable utility plant:					
Electric plant	3 - 25 years	\$ 29,118,078	\$ 14,630,087	\$ -	\$ 43,748,165
Water system	20 years	21,397,218	433,295	-	21,830,513
Sewer system	20 years	19,406,631	722,346	-	20,128,977
General support equipment	2 - 30 years	23,755,955	660,959	-	24,416,914
Administrative equipment	2 - 10 years	<u>658,859</u>	<u>114,840</u>	-	<u>773,699</u>
		94,336,741	16,561,527	-	110,898,268
Less accumulated depreciation		<u>(55,354,465)</u>	<u>(3,953,456)</u>	-	<u>(59,307,921)</u>
		38,982,276	12,608,071	-	51,590,347
Non-depreciable utility plant:					
Construction in progress		<u>2,166,962</u>	<u>13,073,938</u>	<u>(14,663,551)</u>	<u>577,349</u>
		<u>\$ 41,149,238</u>	<u>\$ 25,682,009</u>	<u>\$ (14,663,551)</u>	<u>\$ 52,167,696</u>
	Estimated Useful Lives	Balance at October 1, 2012	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2013
Depreciable utility plant:					
Electric plant	3 - 25 years	\$ 30,718,056	\$ 3,768,830	\$ (5,368,808)	\$ 29,118,078
Water system	20 years	-	21,397,218	-	21,397,218
Sewer system	20 years	-	19,406,631	-	19,406,631
General support equipment	2 - 30 years	23,302,289	506,298	(52,632)	23,755,955
Administrative equipment	2 - 10 years	<u>547,319</u>	<u>133,349</u>	<u>(21,809)</u>	<u>658,859</u>
		54,567,664	45,212,326	(5,443,249)	94,336,741
Less accumulated depreciation		<u>(30,144,337)</u>	<u>(30,453,377)</u>	<u>5,243,249</u>	<u>(55,354,465)</u>
		24,423,327	14,758,949	(200,000)	38,982,276
Non-depreciable utility plant:					
Construction in progress		<u>2,196,741</u>	<u>4,163,520</u>	<u>(4,193,299)</u>	<u>2,166,962</u>
		<u>\$ 26,620,068</u>	<u>\$ 18,922,469</u>	<u>\$ (4,393,299)</u>	<u>\$ 41,149,238</u>

Included in the additions and transfers as of September 30, 2013 are utility plant assets upon merger of WWO (see note 1) as follows:

Water system	\$ 21,397,218
Sewer system	19,406,631
General support equipment	94,892
Administrative equipment	<u>13,415</u>
	40,912,156
Less accumulated depreciation	<u>28,650,761</u>
	<u>\$ 12,261,395</u>

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(7) Utility Plant, Continued

Included in the additions and transfers as of September 30, 2014 are the two sewer assets transferred by the ROP-MOF to PPUC with a total cost of \$1,056,993. The transfer is presented as donated capital in the accompanying statements of revenues, expenses and changes in net position.

In November 2011, the Aimeliik power plant caught fire resulting in damage to several generators and to the plant building. In March 2012, PPUC decided that the damaged generators will not be rehabilitated and will be sold while the cost of the plant building was written down and the other damaged equipment were disposed of. At September 30, 2013, based on evaluation of potential recoverability of the damaged generators held for sale, PPUC recorded a further write down of \$200,000 of the assets' carrying value which is included in the nonoperating revenues (expenses) in the accompanying statements of revenues, expenses and changes in net position.

At September 30, 2013, construction in progress included \$1,991,000 of Japan Government funded projects which involve the rebuilding of the Aimeliik power plant (see note 4). The construction of the new Aimeliik power plant was completed in May 2014.

(8) Long-Term Debt

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

On April 21, 2010, PPUC entered into a loan with a development bank, an affiliated organization, for \$3,000,000 to finance the purchase of two generator sets. The loan is collateralized by the generator sets inclusive of auxiliary equipment. The loan bears interest of 7.5% per annum and is to be repaid monthly beginning January 30, 2011 in principal and interest payments of \$27,810. Payment of interest during the eight month grace period was spread over twelve months with an equal payment of \$12,500 per month starting January 30, 2011.

On March 28, 2014, PPUC entered into two loans with ROP, totaling \$28,158,000, to finance sanitation projects in Koror and Airai areas. The first loan is for \$26,900,000 for twenty years and bears interest equal to the sum of LIBOR plus 0.60% and a maturity premium of 0.10%. Principal is to be repaid semi-annually beginning April 1, 2018 at 2.5% of the total principal amount outstanding on each payment date. The second loan is for \$1,258,000 for twenty years and bears interest at 1% per annum during the period prior to the first principal payment date and 1.5% per annum thereafter. Principal is to be repaid semi-annually beginning April 1, 2018 in installments of \$26,208. PPUC has not drawn related funds as September 30, 2014.

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September 30, 2014 and 2013

(8) Long-Term Debt, Continued

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 548,183	\$ 355,118	\$ 903,301
2016	559,183	330,350	889,533
2017	572,043	302,867	874,910
2018	585,399	275,317	860,716
2019	599,792	246,729	846,521
2020 - 2024	3,256,549	763,532	4,020,081
2025 - 2027	<u>1,419,980</u>	<u>65,006</u>	<u>1,484,986</u>
	<u>\$ 7,541,129</u>	<u>\$ 2,338,919</u>	<u>\$ 9,880,048</u>

Movements in long-term liabilities for the years ended September 30, 2014 and 2013, are as follows:

	<u>Balance at October 1, 2013</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at September 30, 2014</u>	<u>Balance Due in One Year</u>
Long-term debt	\$ <u>8,078,546</u>	\$ <u> -</u>	\$ <u>(537,417)</u>	\$ <u>7,541,129</u>	\$ <u>548,183</u>
	<u>Balance at October 1, 2012</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at September 30, 2013</u>	<u>Balance Due in One Year</u>
Long-term debt	\$ <u>8,606,048</u>	\$ <u> -</u>	\$ <u>(527,502)</u>	\$ <u>8,078,546</u>	\$ <u>537,508</u>

(9) Related Party Transactions

Sale of Utility Services

Utility services of \$7,400,468 and \$7,508,654 were rendered to ROP for the years ended September 30, 2014 and 2013, respectively. PPUC provides utility services to ROP at the same rates charged to third parties.

Receivables of \$1,058,987 and \$967,877 (excluding unbilled receivable of \$475,484 and \$505,307 as of September 30, 2014 and 2013, respectively) are due from ROP for utility services as of September 30, 2014 and 2013, respectively, and are included in the receivable from affiliate in the accompanying statements of net position. Of these receivables, \$114,683 and \$166,822 as of September 30, 2014 and 2013, respectively, have been outstanding for more than ninety days.

Loans from ROP

On March 28, 2014, PPUC entered into two loans with ROP, totaling \$28,158,000, to finance the sanitation projects in Koror and Airai areas (see note 8).

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September 30, 2014 and 2013

(9) Related Party Transactions, Continued

Merger of WWO

As part of the transfer agreement of the WWO (see note 1), ROP was to transfer all grants, appropriations and authorized loan proceeds to PPUC to cover operating costs. For the year ended September 30, 2013, PPUC recognized \$2,672,734 of operating subsidies from ROP as a result of the agreement. As of September 30, 2013, \$2,082,973 remains uncollected and is included in receivables from affiliate in the accompanying statements of net position. The receivable was collected in full as of September 30, 2014. For the year ended September 30, 2014, PPUC recognized \$1,700,000 of WWO operating subsidies from ROP.

In addition to the above, it was agreed that certain utility plant improvements in Koror, Melekeok and Elechui are to be transferred to PPUC when ROP concludes related work. In 2014, ROP transferred two of the plant improvements to PPUC aggregating \$1,056,993. (see note 7).

Others

In October 2007, PPUC entered into a Maintenance Agreement with the National Government of Palau for a period of ten years in line with ROP's utilization of alternative energy technology to reduce dependence on petroleum based fuel products through the installation of solar photovoltaic systems (PV systems). Under the agreement, the National Government shall provide necessary equipment, execute all documents required for receipt of the project resources, and coordinate with the contractor. ROP shall also pay PPUC the energy charge produced by the PV systems and PPUC shall in turn use the payment for maintenance, repair and replacement of components of the PV systems. However, any excess cost incurred in the maintenance, repair and replacement of the PV system shall be borne by ROP. For the years ended September 30, 2014 and 2013, the energy charge incurred by ROP was \$32,676 and \$50,606, respectively.

(10) Commitments

Lease

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

Fuel Supply

In 2011, PPUC renewed its agreement with a contractor effective until December 31, 2016 for the purchase of production fuel. The purchase price was based on movements of the base price for fuel.

In March 2014, PPUC entered into a 5-year fuel supply contract with a contractor for the purchase of production fuel and vehicle fuel and lubricants. The purchase price is based on movements of the base price for fuel and lubricants.

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Notes to Financial Statements
September 30, 2014 and 2013

(11) Contingencies

PPUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, PPUC will be self-insured for the entire amount (see note 12).

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

(12) Risk Management

PPUC 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. PPUC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed, except for inventory and utility plant. Settled claims from insured risks have not exceeded commercial insurance coverage in the past three years. However, PPUC recorded a loss from a fire at the Aimeliik power plant of \$1,208,189 in November 2011.

(13) Dependency on the Republic of Palau

WWO incurred an operating loss of \$4,919,455 for the year ended September 30, 2014. As WWO are primarily funded by ROP subsidies, management believes that its ability to finance future WWO is dependent on continued adequate funding from ROP.

PALAU PUBLIC UTILITIES CORPORATION
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Combining Statement of Net Position
September 30, 2014

<u>ASSETS</u>	<u>Electric Power Operations</u>	<u>Water and Wastewater Operations</u>	<u>Eliminations</u>	<u>Total</u>
Utility plant:				
Depreciable utility plant	\$ 39,675,708	\$ 11,914,639	\$ -	\$ 51,590,347
Non-depreciable utility plant	181,900	395,449	-	577,349
Net utility plant	<u>39,857,608</u>	<u>12,310,088</u>	<u>-</u>	<u>52,167,696</u>
Current assets:				
Cash and cash equivalents	7,189,860	1,249,240	-	8,439,100
Receivables:				
Trade	2,864,924	511,396	-	3,376,320
Affiliate	2,178,969	-	(1,119,982)	1,058,987
Contracts	92,672	28,739	-	121,411
Other	93,657	8,679	-	102,336
	<u>5,230,222</u>	<u>548,814</u>	<u>(1,119,982)</u>	<u>4,659,054</u>
Less allowance for doubtful accounts	<u>(626,000)</u>	<u>(21,000)</u>	<u>-</u>	<u>(647,000)</u>
Net receivables	<u>4,604,222</u>	<u>527,814</u>	<u>(1,119,982)</u>	<u>4,012,054</u>
Prepaid expenses	124,134	122,101	-	246,235
Inventory, net	8,380,427	119,648	-	8,500,075
Due from grantor agency	118,000	-	-	118,000
Total current assets	<u>20,416,643</u>	<u>2,018,803</u>	<u>(1,119,982)</u>	<u>21,315,464</u>
Other non-current assets:				
Contracts receivable, net of current portion	203,036	4,379	-	207,415
	<u>\$ 60,477,287</u>	<u>\$ 14,333,270</u>	<u>\$ (1,119,982)</u>	<u>\$ 73,690,575</u>
<u>LIABILITIES AND NET POSITION</u>				
Net position:				
Net investment in capital assets	\$ 34,916,479	\$ 12,310,088	\$ -	\$ 47,226,567
Unrestricted	10,593,960	(42,321)	-	10,551,639
Total net position	<u>45,510,439</u>	<u>12,267,767</u>	<u>-</u>	<u>57,778,206</u>
Commitments and contingencies				
Current liabilities:				
Current portion of long-term debt	548,183	-	-	548,183
Accounts payable	6,565,240	1,350,489	(1,119,982)	6,795,747
Accrued expenses	386,584	715,014	-	1,101,598
Customer deposits	473,895	-	-	473,895
Total current liabilities	<u>7,973,902</u>	<u>2,065,503</u>	<u>(1,119,982)</u>	<u>8,919,423</u>
Long-term debt, net of current portion	<u>6,992,946</u>	<u>-</u>	<u>-</u>	<u>6,992,946</u>
Total liabilities	<u>14,966,848</u>	<u>2,065,503</u>	<u>(1,119,982)</u>	<u>15,912,369</u>
	<u>\$ 60,477,287</u>	<u>\$ 14,333,270</u>	<u>\$ (1,119,982)</u>	<u>\$ 73,690,575</u>

See accompanying independent auditors' report.

PALAU PUBLIC UTILITIES CORPORATION
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Combining Statement of Revenues, Expenses and Change in Net Position
Year Ended September 30, 2014

	Electric Power Operations	Water and Wastewater Operations	Eliminations	Total
Operating revenues:				
Power	\$ 27,308,961	\$ -	\$ (2,384,420)	\$ 24,924,541
Water	-	1,602,571	(36,361)	1,566,210
Wastewater	-	636,098	-	636,098
Other	634,458	37,874	-	672,332
Total operating revenues	27,943,419	2,276,543	(2,420,781)	27,799,181
Provision for uncollectible receivables	(291,855)	(21,000)	-	(312,855)
Net operating revenues	27,651,564	2,255,543	(2,420,781)	27,486,326
Operating expenses:				
Generation - fuel	18,732,306	-	-	18,732,306
Depreciation	2,187,173	1,766,283	-	3,953,456
Generation - other cost	3,503,046	-	(30,318)	3,472,728
Administration	920,174	772,207	(50,238)	1,642,143
Distribution and transmission	813,236	-	(25,884)	787,352
Engineering services	554,192	-	(12,650)	541,542
Renewable energy	92,185	-	(6,669)	85,516
Water operations	-	3,655,550	(1,822,059)	1,833,491
Wastewater operations	-	980,958	(472,963)	507,995
Total operating expenses	26,802,312	7,174,998	(2,420,781)	31,556,529
Operating income (loss)	849,252	(4,919,455)	-	(4,070,203)
Nonoperating revenues (expenses):				
Operating subsidies from the Republic of Palau	100,729	1,700,000	-	1,800,729
Grants from the Japan Government	266,203	-	-	266,203
Grants from the United States Government	45,000	-	-	45,000
Interest income	1,237	179	-	1,416
Interest expense	(383,207)	-	-	(383,207)
Other	121,609	136,434	-	258,043
Total nonoperating revenues (expenses), net	151,571	1,836,613	-	1,988,184
Income (loss) before capital contributions	1,000,823	(3,082,842)	-	(2,082,019)
Capital contributions:				
Donated capital from the Republic of Palau	-	1,056,993	-	1,056,993
Grants from the Japan Government	13,131,208	-	-	13,131,208
Change in net position	14,132,031	(2,025,849)	-	12,106,182
Net position at beginning of year	31,378,408	14,293,616	-	45,672,024
Net position at beginning of year	\$ 45,510,439	\$ 12,267,767	\$ -	\$ 57,778,206

See accompanying independent auditors' report.