

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

Year Ended September 30, 2016

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

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SEPTEMBER 30, 2016

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Belau Submarine Cable Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of net position of Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), as of September 30, 2016, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise BSCC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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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 BSCC. as of September 30, 2016, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (MD&A) on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2017 on my consideration of the BSCC's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering BSCC's internal control over financial reporting and compliance.



Koror, Republic of Palau
June 6, 2017

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

Management's Discussion and Analysis
September 30, 2016

Management's Discussion and Analysis

This section of Belau Submarine Cable Corporation's (BSCC) annual financial report presents the analysis of its financial performance during the fiscal year ended September 30, 2016. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section. Responsibility for the completeness and fairness of this information rests with the Corporation.

As management of the Belau Submarine Cable Corporation, a component unit of the Republic of Palau (ROP), we offer readers of the Corporation's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended September 30, 2016. 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 9 through 25.

Using This Annual Report

The Belau Submarine Cable Corporation's financial statements are designed to emulate corporate presentation models whereby all Corporation activities are consolidated into one total. The focus of the Statement of Net Position is designed to be similar to bottom line results for the Corporation. This Statement combines and consolidates current financial resources (short-term spendable resources) with capital assets. The Statement of Revenues, Expenses, and Changes in Net Position focus on BSCC's initial activities, which are supported mainly by Loans from the Republic of Palau. This approach is intended to summarize and simplify the user's analysis of cost of various BSCC services to the public.

Overview of Financial Statements

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

Basic Financial Statements

The *Statement of Net Position* reflects the financial position of the Corporation as of September 30, 2016. It shows the assets owned or controlled, deferred outflows of resources, related liabilities and other obligations, deferred inflows of resources, and the categories of net position. Net position is an accounting concept defined as total assets and deferred outflows less total liabilities and deferred inflows. Since the Corporation is in its first, there are no deferred outflows and inflow of resources reported in the accompanying financial statements. As such, it represents the residual of all other elements presented in the Statement of Net Position of the Corporation.

BELAU SUBMARINE CABLE CORPORATION

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Management's Discussion and Analysis

September 30, 2016

The *Statement of Revenues, Expenses, and Changes in Net Position* reflects the results of operations and other changes for the year ended September 30, 2016. It shows revenues and expenses, both operating and non-operating, and reconciles the beginning net position amount to the ending net position amount, which is shown on the Statement of Net Position described above.

The *Statement of Cash Flows* reflects the inflows and outflows of cash for the year ended September 30, 2016. It shows the cash activities by type and reconciles the beginning cash amount to the ending cash amount, which is shown on the *Statement of Net Position*, described above. In addition, this Statement reconciles cash flows from operating activities to operating loss on the *Statement of Revenues, Expenses, and Changes in Net Position* described above.

Notes to the Financial Statements

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

The Belau Submarine Cable Corporation (BSCC) was in start-up mode during the fiscal year ended September 30, 2016. BSCC was established by RPPL 9-47 (BSCC Act) on September 21, 2015 as a state-owned corporation to procure, own and manage a submarine fiber optic cable for the Republic of Palau.

Current Status of Project

The current scope of the project will be completed well within the \$25M funding envelope. It includes:

- An Indefeasible Right of Use (IRU) with Globe Telecom International (GTI) of Philippines for five 100 Gigabit per second wavelengths on the SEA-US cable that will be Ready For Service (RFS) in July 2017. That is, at the time of writing this analysis, SEA-US is already in the final stages of completion. The IRU is a capacity ownership contract for the span from the Palau Branching Unit (BU) 3a to the Guam Telecom (GTA) Cable Landing Station in Guam.
- Construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths.
- Construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, approximately 220 km, including all CLS Submarine Line Terminating Equipment (SLTE), Power Feed Equipment (PFE), Network Protection Equipment (NPE) and network management systems and equipment, plus industry standard spares.

BELAU SUBMARINE CABLE CORPORATION

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September 30, 2016

It is possible that the scope of the project will be expanded so BSCC can fulfil its charter to provide equal access to its customers, since the CLS site, while the best available in Republic of Palau for a submarine cable landing, is somewhat remote from the main population centers. A proposal to extend the network with fiber along the roadside to an additional Customer Access Point (CAP) in Airai has been put to Asian Development Bank (ADB). If this extension is approved, it can be accommodated within the funding envelope.

The current approved scope is in an advanced state of construction. The CLS is in place and waiting on arrival of a diesel generator and Automatic Transfer Switch (ATS) to complete the power systems. The IP Radio tower will be arriving in Palau this month. The challenging lay through the West Passage has been completed, with a 7km Pre-Lay Shore End completed on 6th June 2017. Remaining key project milestones are:

- By July 2017, all the power systems for the Cable Landing Station will be installed, ready for the CLS equipment that will be installed by the prime contractor, NEC.
- In late August 2017, the cable ship KDDI *Pacific Link* will pick up the PLSE landed on 6th June, and make the final splice.
- Installation and testing will proceed through early November 2017, to Provisional Acceptance (PA), when BSCC will make the system available to its customers i.e. the Palau Service Providers, for their testing.
- In December 2017, Ready For Service (RFS).

BSCC's business model is shaped by the provisions of the BSCC Act. We are a wholesale carrier, selling only to service providers, at full economic cost (including financing cost). In such a capital-intensive commodity business, the key to maximizing the overall end user goals of improved services at significantly lower unit prices is to ensure that the construction cost is managed effectively, with an uncompromising focus on quality. Current expected cost to complete (including contingency) is \$22.7M. Every component is tested at factory, after loading for shipping, after installation and again in final system testing.

The main risk to BSSC fulfilling its objectives is in over-estimating demand growth. However, BSCC's demand forecasts are at the low end of those experienced in other Pacific Island markets when submarine fiber optic cable is connected. Management expects that Business Plan demand growth forecasts will be significantly exceeded. Better short-term demand data will be available after BSCC commences sales activity in July 2017.

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

Management's Discussion and Analysis
September 30, 2016

Financial Statements for the Year Ended September 30, 2016

Statement of Net Position

September 30, 2016

ASSETS

Current assets:	
Cash	\$ <u>276,098</u>
Capital Assets:	
Non-depreciable capital asset	275
Capital asset under construction	2,674,227
Indefeasible right of use	<u>3,122,200</u>
	<u>\$ 6,072,800</u>

LIABILITIES AND NET ASSETS

Non-current Liabilities:	
Long-term debt	\$ 5,767,827
Net Position:	
Net investments in capital assets	28,875
Unrestricted	<u>276,098</u>
	<u>304,973</u>
	<u>\$ 6,072,800</u>

Statement of Revenues and Expenses and Changes in Net Position

Year Ended September 30, 2016

Non-operating revenues (expenses):	
Republic of Palau appropriations	\$ 305,000
Postage and delivery	(30)
Interest income	<u>3</u>
Total non-operating revenues, net	<u>304,973</u>
Net position, beginning of year	<u>-</u>
Net position, end of year	<u>\$ 304,973</u>

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

Management's Discussion and Analysis
September 30, 2016

Statement of Cash Flows
Year Ended September 30, 2016

Cash flows from operating activities:

Cash paid to suppliers for goods and services \$ (30)

Cash flows from capital and related financing activities:

Additions to capital assets (2,674,502)

Acquisition of indefeasible right of use (3,122,200)

Proceeds from long-term debt 5,767,827

Operating subsidy from the Republic of Palau 305,000

Net cash provided by capital and related financing activities 276,125

Cash flows from investing activities:

Interest received on cash in bank 3

Net change in cash

Cash, beginning of year 276,098

Cash, end of year -

\$ 276,098

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

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

While in start-up in FY 2016, the BSCC Board of Directors contracted with Globe Telecom International (GTI) to secure capacity on the SEA-US cable to Guam; with NEC for the turnkey fixed price construction of the network; and with McCann Consulting International (MCI) to operate the Project Management Unit. All contracting was in accordance with ADB procurement guidelines.

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Management's Discussion and Analysis
September 30, 2016

Initial Payments were made under those contracts, as follows:

GTI	\$ 3,122,200
NEC	2,623,738
MCI	<u>37,499</u>
	<u>\$ 5,783,437</u>

Payments were also made to Republic of Palau for interest expense, to the Post Office for a post office box and to Ngeremlengui State for land acquisition. As BSCC had not commenced operations, there was no income for FY 2016 except bank interest.

BSCC has hired a CEO and construction of the network has commenced. To date the project is on schedule and under budget.

Economic Factors that will affect the Future

In most markets world-wide, capacity demand growth has proved remarkably impervious to fluctuations in overall economic activity. However, given the significant tourist numbers in Palau relative to the resident population, a sustained downturn in tourist arrivals would have a negative impact on BSCC revenue growth.

Requests for Information

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

Robin Russell
Chief Executive Officer
PO Box 9
Koror, Palau 96940

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

Statement of Net Position
September 30, 2016

ASSETS

Current assets:	
Cash	\$ <u>276,098</u>
Capital Assets:	
Non-depreciable capital asset	275
Capital asset under construction	2,674,227
Indefeasible right of use	<u>3,122,200</u>
	<u>\$ 6,072,800</u>

LIABILITIES AND NET ASSETS

Non-current Liabilities:	
Long-term debt	\$ 5,767,827
Commitments	
Net Position:	
Net investments in capital assets	28,875
Unrestricted	<u>276,098</u>
	<u>304,973</u>
	<u>\$ 6,072,800</u>

See accompanying notes to financial statements.

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

Statement of Revenues and Expenses and Changes in Net Position
Year Ended September 30, 2016

Non-operating revenues (expenses):	
Republic of Palau appropriations	\$ 305,000
Postage and delivery	(30)
Interest income	<u>3</u>
Total non-operating revenues, net	<u>304,973</u>
Net position, beginning of year	<u>-</u>
Net position, end of year	<u>\$ 304,973</u>

See accompanying notes to financial statements.

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

Statement of Cash Flows
Year Ended September 30, 2016

Cash flows from operating activities:	
Cash paid to suppliers for goods and services	\$ <u>(30)</u>
Cash flows from capital and related financing activities:	
Additions to capital assets	(2,674,502)
Acquisition of infeasible right of use	(3,122,200)
Proceeds from long-term debt	5,767,827
Operating subsidy from the Republic of Palau	<u>305,000</u>
Net cash provided by capital and related financing activities	<u>276,125</u>
Cash flows from investing activities:	
Interest received on cash in bank	<u>3</u>
Net change in cash	
Cash, beginning of year	276,098
Cash, end of year	<u>-</u>
	<u>\$ 276,098</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2016

(1) Organization and Summary of Significant Accounting Policies

Organization

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

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

Basis of Accounting and Presentation

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

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

BSCC implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Government as amended by GASB Statement No. 37, Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* in a statement of financial position.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2016

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

BSCC follows the business-type activities requirements of GASB Statement No. 34. This approach requires the following components of BSCC's financial statements:

- Management's discussion and analysis;
- Basic financial statements, including a statement of net position, statement of revenues, expenses and changes in net position and a statement of cash flows using the direct method; and
- Notes to financial statements

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, requires BSCC to establish net position categories as follows:

Net investment in capital assets:

Capital assets net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction or improvements of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should be included in this component of net position. At September 30, 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.

Restricted:

Restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. At September 30, 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of restricted net position.

Unrestricted:

Net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties. At September 30, 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2016

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

Cash

For the purposes of the Statement of Net Assets and Statement of Cash Flows, BSCC considers cash to be cash on hand plus cash in checking and savings accounts. All of BSCC's cash deposits are with a federally insured bank, \$250,000 of which is subject to coverage by federal insurance and is within insurable limits as of September 30, 2016.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. BSCC capitalizes buildings, land improvements and equipment that have a cost of \$200 or more and an estimated useful life of at least five years. The cost of maintenance and repairs is charged to expense. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

Capital Asset Under Construction

The capital asset under construction represents the cost incurred for the submarine fiber optic spur to-date totaling \$2,674,227 as of September 30, 2016. This will include the construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths.

It also includes the construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, including all CLS Submarine Line Terminating Equipment, Power Feed Equipment, Network Protection Equipment and network management systems and equipment, plus industry standard spares.

Indefeasible Right of Use

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. In FY 2016, BSCC was a newly incorporated governmental entity with no employees and had not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, it did not report any deferred outflows of resources for the year ended September 30, 2016.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. In FY 2016, BSCC was a newly incorporated governmental entity with no employees and had not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, it did not report any deferred outflows of resources for the year ended September 30, 2016.

Net Position

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

Pensions

Pensions are required to be recognized and disclosed using the accrual basis of accounting. In FY 2016, BSCC was a newly formed governmental entity with no employees and had not made any contributions and has not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, BSCC did not recognize a net pension liability and pension expense in the accompanying financial statements for the year ended September 30, 2016.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

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

Non-operating Revenues and Expenses

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

Income Taxes

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

New Accounting Standards

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment.

The provisions in Statement No. 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and will not have a material effect on the financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68 and Amendments to Certain Provisions of GASB Statement 67 and 68*, which aligns the reporting requirements for pensions and pension plan not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental non-employer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statements will have on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

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Notes to Financial Statements
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(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standards are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement had a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 31, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units- an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

BELAU SUBMARINE CABLE CORPORATION
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(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Deposits and investments

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

Deposits

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

- | | |
|------------|--|
| Category 1 | Deposits that are federally insured or collateralized with securities held by BSCC or its agent in the BSCC's name; |
| Category 2 | Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the BSCC's name; or |
| Category 3 | Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in BSCC's name and noncollateralized deposits. |

BELAU SUBMARINE CABLE CORPORATION
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(2) Deposits and investments, Continued

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

For credit risk in the case of deposits, there is the risk that in the event of a bank failure, BSCC's deposits may not be returned to it. As of September 30, 2016, the carrying amount of BSCC's total cash in checking and savings was \$276,098 with a corresponding bank balance of \$276,128. From these deposits, \$250,000 at September 30, 2016 was subject to coverage by FDIC. BSCC does not require collateralization of bank accounts, and therefore, amounts in excess of insurable limits are uncollateralized and are subject to custodial credit risk.

Investments

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

- | | |
|------------|--|
| Category 1 | Investments that are insured or registered, or securities held by BSCC or its agent in BSCC's name; |
| Category 2 | Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the BSCC's name; or |
| Category 3 | Investments that are uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in BSCC's name. |

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

As of September 30, 2016, BSCC did not have investments subject to GASB Statement No. 40.

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September 30, 2016

(3) Indefeasible Right of Use (IRU) Agreement

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

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

Total purchase price of \$6.7 million is due and payable in installments through the IRU RFS date, of which \$885,400 is due in 2017 and \$2,658,934 is due on or before the IRU RFS date. As of September 30, 2016, \$3,11,200 of the purchase price has been paid. Since the IRU RFS date has not yet commenced, no amortization of the IRU has been recognized for the year ended September 30, 2016.

(4) Long-Term Debt

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

Under the Project Agreement, ADB has agreed to:

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

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

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September 30, 2016

(4) Long-Term Debt, continued

Long-term debt at September 30, 2016 is as follows:

Loan payable under the Ordinary Operations Loan Agreement, with a 20-year term after the grace period ends on June 1, 2021 when the first principal repayment becomes due, interest at LIBOR plus 0.50% per annum and payable every June 1 and December 1. Principal is to be repaid at 2.5% of the total principal amount outstanding on each payment date. \$3,800,769

Loan payable under the Ordinary Operations Loan Agreement, with a 20-year term after the grace period ends on June 1, 2021 when the first principal repayment of \$213,250 becomes due, interest at two percent (2%) per annum and payable every June 1 and December 1. 1,967,058

\$5,767,827

As of September 30, 2016, amounts available under the Ordinary and Special Operations Loan Agreements that may be drawn in subsequent years approximate \$12.7 million and \$6.6 million, respectively. Given the difference after predicting when additional drawdowns will occur, presentation of future principal and interest amortization is not possible at this time.

(5) Construction and Other Commitments

BSCC has entered into a supply contract with a third party for the Project's construction and installation that is expected to be completed by December 31, 2017. Approximately \$9.7 million is outstanding under the contract as of September 30, 2016.

Additionally, BSCC entered into a project management/consultancy agreement with another third party to undertake activities necessary to ensure timely, cost-effective and secure installation and implementation of the Project in compliance with the terms and conditions of the Project Agreement, including loan agreements, with ADB. The agreement covers the period from September 2016 to July 2018. As of September 30, 2016, total commitments related to this agreement approximate \$599,000.

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Notes to Financial Statements
September 30, 2016

(6) Pension Plan

The Belau Submarine Cable Corporation did not participate or contribute to the Palau Civil Service Pension Trust Fund (the Fund), during the year ended September 30, 2016. The Fund is 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 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. 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 deducted from the member's dollar for dollar by the employer.

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, 2015 applicable to the plan year ending September 30, 2015 of the ROP Civil Service Pension Plan:

Actuarial Cost Method	: Normal costs are calculated under the entry age normal method
Investment Income	: 7.5% per year
Expenses	: \$300,000 each year
Salary Increase	: 3% per year
Mortality	: RP 2000 Combined Healthy Mortality Table, set forward four years
Disabled Mortality	: PBGC Mortality Table for Disabled Persons Receiving Social Security
Retirement Age	: Age 60 and contributed for at least 5 years

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Notes to Financial Statements
September 30, 2016

(6) Pension 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.

Based on the actuarial valuation of the Fund as of October 1, 2015, the actuarial valuation determined the unfunded pension benefit obligation as follows:

Accrued liability as of October 1, 2015 for:

Present value of Future Benefits	\$ 187,644,517
Present value of Future Normal Costs	<u>(26,735,675)</u>
Actuarial Accrued Liability	160,908,842
Market value of assets	(28,115,140)
Unfunded Actuarial Accrued Liability	\$ <u>132,793,702</u>
Funded ratio (ratio of assets to liabilities)	17.5%

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.

(7) Republic of Palau

During the year ended September 30, 2016, the Republic of Palau (ROP) appropriated and contributed \$305,000 through RPPL 9-47 as the initial funding to secure the ROP's interest in the fiber optic submarine cable.

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Notes to Financial Statements
September 30, 2016

(8) Fair Value of Financial Instruments

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

(9) Risk Management

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

BSCC is self-insured for underwater cables.

Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported during the year ended September 30, 2016.

(10) Subsequent Events

BSCC has evaluated subsequent events from October 1, 2016 through June 6, 2017, the date the financial statements were available to be issued. BSCC did not note any subsequent events requiring disclosure or adjustment to the accompanying financial statements.

BELAU SUBMARINE CABLE CORPORATION
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INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

Year Ended September 30, 2016



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

Board of Directors
Belau Submarine Cable Corporation

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Belau Submarine Cable Corporation (the Corporation), which comprise the statement of net position as of September 30, 2016, and the related statements of revenues, expenses and changes in net position and the statement of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 6, 2017.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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



Koror, Republic of Palau
June 6, 2017