

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

FINANCIAL STATEMENTS,
ADDITIONAL INFORMATION
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2016 AND 2015

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, 2016 and 2015, 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, 2016 and 2015, 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 18 as well as the Schedule of Proportional Share of the Net Pension Liability on page 43 and the Schedule of Pension Contributions on page 44 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, Combining Statement of Revenues, Expenses and Changes in Net Position, Combining Statements of Cash Flows, and Schedule of Revenues and Expenses on pages 45 through 48 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Combining Statement of Net Position, Combining Statement of Revenues, Expenses and Changes in Net Position, Combining Statements of Cash Flows, and Schedule of Revenues and Expenses 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 30, 2017, 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.



June 30, 2017

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

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis (MD&A) presents the Palau Public Utilities Corporation's (PPUC)'s financial performance during the fiscal year ended September 30, 2016. The analysis will provide the users with the information they need to assist them in assessing whether PPUC's financial position has improved or deteriorated as result of the current fiscal year's operation. This analysis is to be read in conjunction with the audited financial statements as of and for the year ended September 30, 2016, 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.

COMPANY OVERVIEW

The Public Utilities Corporation (PUC) was created on July 06, 1994. PUC was mandated by law to plan, develop and execute an electrification plan for the entire Republic. On June 6, 2013, a Republic of Palau law, RPPL No. 9-4, was signed into law that consolidated two independent public corporations, the Palau Water & Sewer Corporation (PWSC) and the Palau Public Utilities Corporation under one identity, the Palau Public Utilities Corporation. The intent of the consolidation was to streamline administrative processes and reduce operating costs. It is anticipated that little will change on the operations side, but the administration and the back office processes should be materially affected.

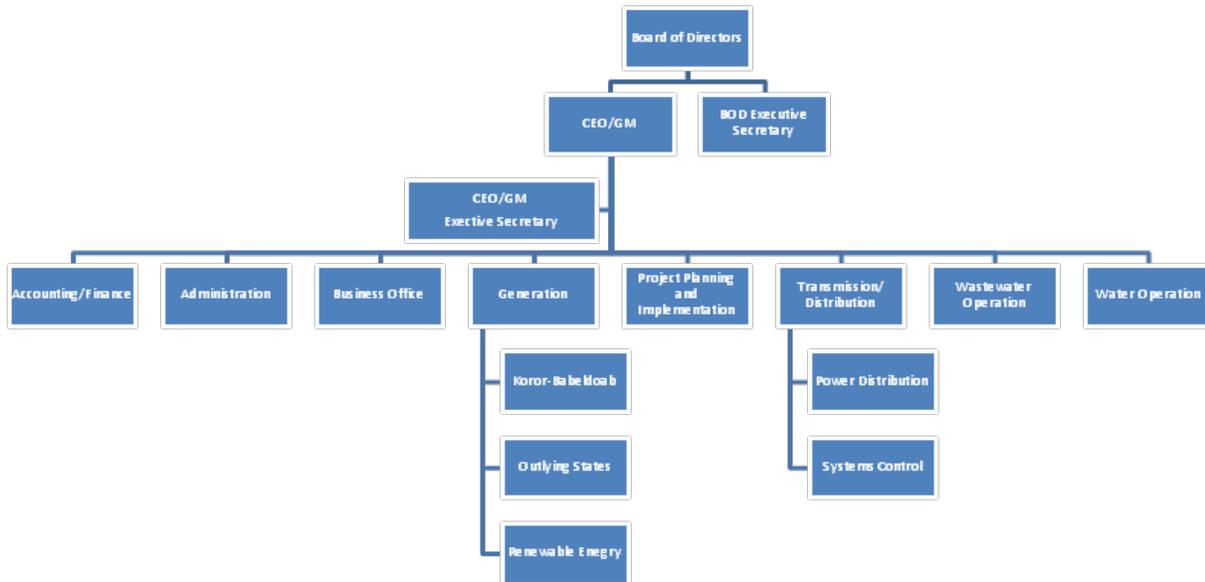
After the merger, about 112 employees from the National Government's water and waste water operations transitioned to PPUC. From an Electrical utility with 149 employees, PPUC now has a total workforce of over 200 employees serving both the electricity and water/waste water operations of the Republic of Palau.

Water and Waste Water operation is treated as a separate business segment from the Electric operations and have its own organizational chart delineating a chain of management that is separate from the electrical operations. Shared administrative costs and expertise are allocated to the two separate business segments and shall not be utilized to subsidize each other.

An organizational chart was created and adopted by the Board of Directors. The new organizational chart is modified to indicate the merging of shared services. These include the Business Office Department, Information Technology, Procurement, Accounting and Finance, Public Relations, Grants Coordination and Human Resources. Electrical operations and the water and waste water operations remain as separate operations supported by the shared administrative services.

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Years Ended September 30, 2016 and 2015

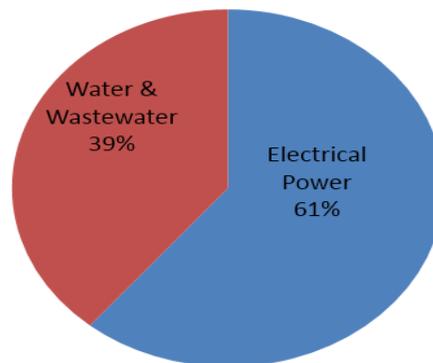


PPUC is overseen by a seven (7) member Board of Directors appointed by the President of Republic of Palau with the advice and consent of the Palau National Senate. The Board of Directors is entrusted to exercise the corporate powers of PPUC. Ultimately, this includes the hiring of a Chief Executive Officer (CEO) with proven ability and skills in the operation of finances, personnel and management of a utility company. The CEO is responsible for the daily operations of PPUC.

Human Resource and Workforce Overview

The Palau Public Utilities Corporation employs 254 employees spread across ten departments, however divided into two main operations, the Electrical Power Operations and the Water and Wastewater Operations.

Employee Distribution by Operations



- Electrical Power: 155 Employees
- Water & Wastewater: 99 Employees

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Years Ended September 30, 2016 and 2015

PPUC employs 215 males, comprising 85% of the workforce and 39 females, comprising 15%. The workforce is predominantly male which is typical in the utility industry, and PPUC is no exception. All five engineers, including the CEO are males. Adhering to the Republic of Palau's Constitutional mandate to prioritize hiring of Palauans, the PPUC Board of Directors, CEO and Senior Management Team are keen on fulfilling this mandate and as evidenced that 95% of the workforce is Palauan and 5% is Non-Palauan. It is noteworthy mentioning that all, except for two engineers in the corporation are Non-Palauans. Continuous efforts are expended in looking for scholarship and training opportunities to up skill and equip our Palauan workforce to cope with challenges of advancing technology, practices and methods in the industry.

In accordance with RPPL 9-4, employees that garner yearly salaries of \$40,000 and over should be on contract. In addition, the PPUC Personnel Manual states that employees hired for a specific purpose or to fill out skills that are not readily available in Palau are employed on a contract. Contract employees comprise 5% while permanent employees make up 95% of the workforce.

Through the various school field trips and internship hosting programs through the Palau National Scholarship Board, Workforce Opportunity Innovation Act programs, and outreach activities, PPUC is aiming to ignite and fuel interest, inspire and motivate Palauans, and Palauan young women to explore and further their education in Engineering, Finance, Water, Wastewater and Electrical Operations professional technical fields.

PPUC Milestones since the Merger

1. Shared Administration Support (Cross -Cutting Services)
 1. Management Information System (MIS) is now functional
 2. Department assessments completed and re-organized
 3. HR Office is actively recruiting manpower with required expertise
 4. Suppliers and contractor's relationship or partnership with PPUC has improved
 5. Corporate Plans/Strategic Direction endorsed by Board of Directors
 6. Improved and formalized work flow process and policy compliance
2. Electrical Power Operation (EPO)
 1. Financially sustainable with reserves for Capital Improvement Projects (CIP)
 2. Major CIPs completed and new ones to commence will improve service efficiencies
 3. Obtained external grants for systems assessment and Renewable Energy project
 4. Cost cutting measures for power generation and distributions
 5. Additional revenue source from streetlights and power pole rental agreements with State governments
 6. Specialized training for employee development
3. Water and Wastewater Operation (WWO)
 1. In 3 years - from crawling to now running
 2. Achieved approximately 70 % mandate for achieving full-cost recovery
 3. Replacements of over 30 old sewer pump stations
 4. Replacements and upgrades of Outlying States water systems and facilities
 5. Metering program completed in 8 states
 6. JICA ODA Water Improvement Project to improve Koror-Airai water system transmission and distribution lines on-going with target date for completion by mid-year 2018
 7. ADB Koror-Airai Sanitation Project to upgrade sewer system network and construct wastewater treatment plant is on-going with a target date for completion by early 2019

PPUC has grown from 1,500 connections while under the National Government management into a public utility serving over 6,800 customers comprised of 26% residential, 41% commercial, 27% Government and 6% others.

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Electric Power Operation (EPO)

PPUC has a current real capacity of slightly over 28MW with power plants located at Malakal-Koror, Aimeliik, Peleliu, Angaur and Kayangel. The Malakal and Aimeliik Power Plants provide power to the central grid supplying Koror, Melekeok—the capital city, and the rest of Babeldaob. Peak demand is usually between 11 to 12 MW. The two power plants are located in Koror and Babeldaob 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.

With aged and inefficient electrical grid which have contributed to frequent power outages, PPUC plans to hire a consultant to do the assessment project to investigate and assess the electricity transmission and distribution system in Koror and Babeldaob for the purpose of modernizing, improving efficiency and introduce and diversify the renewable energy mix to the grid.

PPUC established a Renewable Energy Division (RED) mandated to research, explore, and develop a renewable energy sector to "improve energy security by diversifying the supply of energy to the people of Palau, including renewable-energy, and promoting progressive policy development and implementation by a more robust, cost-effective, and efficient Energy administration" in line with the National Energy Policy. Although there are various solar energy systems in the Republic, RED has assumed full management and maintenance of the solar systems installed at the Palau International Airport and the Capitol building at Ngerulmud. Further, the division provides technical assistance and maintenance of the solar systems managed by the National Government as the need arises.

PPUC succeeded in its negotiation to transfer the ownership of the streetlights maintenance to the various state governments resulting in numerous approved Memorandum of Understanding between PPUC and the States, thus, cost of the maintenance and kWh consumptions of the streetlights are now paid for by the States.

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. In addition to upgrades and expansion efforts, management is cognizant of the high cost of maintenance which financially impacts on customers, thus, continuing to undertake proactive efforts to control and minimize costs.

PPUC has traditionally played a vital role by providing utilities with valuable knowledge and capabilities that are keys to a primary business function - delivering power in a reliable and safe manner. A quality SCADA solution is central to effective operation of a utility's most critical and costly distribution, transmission and generation assets. The SCADA system which was first installed in the early 1990 was finally replaced and upgraded.

The improved financial sustainability of the electric operation has allowed for major capital improvement projects that are aimed to improve efficiency and reduce operational cost. The following projects were implemented and/or in the construction phase during 2015 and 2016:

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<u>EPO Major CIPs (2015-2016)</u>	<u>Amount</u>
Information Technology	\$ 200,000
Power Poles & Distribution Line Assessment	350,000
Supply & Installation of HV XLPE Power Cables (KB Bridge)	500,000
Upgrading of SCADA System - Phase 2	100,000
APP Oil & Water Separator	86,478
APP Power Plant Workshop	4,475
APP Mitsubishi Generator Spare Parts Storage Room	20,132
APP Cargo/Charging Pipeline	1,000,000
APP Tank Farm Repair	818,097
Existing Trench Backfilling Phase 3	30,000
Tank Farm Perimeter Lighting System	20,000
System Air Vent Motor replacement	40,000
Constructing Office Space	50,000
APS Roof Replacement	37,950
Repair of Fuel Tank	40,000
Repair of Power Plant Roofing	40,000
Total	\$ 3,337,132

The capital improvement projects implementation are prioritized such that the outcome of the projects will maintain or improve performance against developed fuel efficiency and energy loss benchmarks.

PPUC EPO Financial Highlights

The following table shows the revenues, expenses and changes in net position of the electrical operation for the past three fiscal years ended September 30, 2014 through September 30, 2016:

(Dollars in thousands)

EPO	Sept 30, 2016	Sept 30, 2015	Sept 30, 2014	Inc (Dec) 2016	Inc (Dec) 2015
Statements of Net Position					
Current Assets	\$ 23,638	\$ 19,038	\$ 20,417	\$ 4,600	\$ (1,379)
Other Assets	195	263	203	(68)	60
Net Utility Plant	<u>35,882</u>	<u>36,825</u>	<u>39,858</u>	<u>(943)</u>	<u>(3,033)</u>
Total Assets	<u>59,715</u>	<u>56,126</u>	<u>60,478</u>	<u>3,589</u>	<u>(4,352)</u>
Deferred Outflows of Pension	<u>843</u>	<u>591</u>	<u>105</u>	<u>252</u>	<u>486</u>
	<u>\$ 60,558</u>	<u>\$ 56,717</u>	<u>\$ 60,583</u>	<u>\$ 3,841</u>	<u>\$ (3,866)</u>
Current Liabilities	\$ 6,297	\$ 5,728	\$ 7,975	\$ 569	\$ (2,247)
Other Liabilities	5,862	6,434	6,993	(572)	(559)
Net Pension Liability	<u>7,915</u>	<u>7,712</u>	<u>7,190</u>	<u>203</u>	<u>522</u>
Total Liabilities	<u>20,074</u>	<u>19,874</u>	<u>22,158</u>	<u>200</u>	<u>(2,284)</u>
Deferred Inflows of Pension	<u>1,112</u>	<u>877</u>	<u>739</u>	<u>235</u>	<u>138</u>
	<u>\$ 21,186</u>	<u>\$ 20,751</u>	<u>\$ 22,897</u>	<u>\$ 435</u>	<u>\$ (2,146)</u>
Investment in Capital Assets	\$ 31,632	\$ 32,224	\$ 34,916	\$ (592)	\$ (2,692)
Unrestricted	<u>7,740</u>	<u>3,742</u>	<u>2,770</u>	<u>3,998</u>	<u>972</u>
Total Net Position	<u>\$ 39,372</u>	<u>\$ 35,966</u>	<u>\$ 37,686</u>	<u>\$ 3,406</u>	<u>\$ (1,720)</u>

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The value of the assets increased by \$3.8 million and is a direct result of the increased savings in the capital maintenance account. The increase in liability is direct result of the increase in pension liabilities. The overall increase in net position is \$3.4 million.

(Dollars in thousands)

EPO	Sept 30, 2016	Sept 30, 2015	Sept 30, 2014	Inc (Dec) 2016	Inc (Dec) 2015
Revenues, Expenses, and Changes in Net Position					
Operating Revenues:					
Electric	\$ 19,807	\$ 21,057	\$ 27,308	\$ (1,250)	\$ (6,251)
Others	908	772	634	136	138
Provision for bad debts	(73)	-	(292)	(73)	292
Nonoperating Revenue/Exp	<u>1,012</u>	<u>(163)</u>	<u>152</u>	<u>1,175</u>	<u>(315)</u>
Total Revenue	<u>21,654</u>	<u>21,666</u>	<u>27,802</u>	<u>(12)</u>	<u>(6,136)</u>
Operating Expenses:					
Generation fuel	10,135	14,555	18,732	(4,420)	(4,177)
Generation other costs	2,436	3,830	3,454	(1,394)	376
Depreciation	2,672	2,615	2,187	57	428
Admin	973	857	920	116	(63)
D&T	1,251	935	813	316	122
Engineering	335	496	554	(161)	(58)
Renewable energy	<u>538</u>	<u>98</u>	<u>92</u>	<u>440</u>	<u>6</u>
Total Operating Expenses	<u>18,340</u>	<u>23,386</u>	<u>26,752</u>	<u>(5,046)</u>	<u>(3,366)</u>
Capital Contributions	<u>92</u>	<u>-</u>	<u>13,131</u>	<u>92</u>	<u>(13,131)</u>
Change in Net Position	3,406	(1,720)	14,181	5,126	(15,901)
Beginning Net Position	<u>35,966</u>	<u>37,686</u>	<u>23,505</u>	<u>(1,720)</u>	<u>14,181</u>
Ending Net Position	<u>\$ 39,372</u>	<u>\$ 35,966</u>	<u>\$ 37,686</u>	<u>\$ 3,406</u>	<u>\$ (1,720)</u>

The operating revenue declined by approximately 6% and it is due to the reduction of the average cost of fuel during the fiscal year which ultimately reduced the fuel cost for power plant.

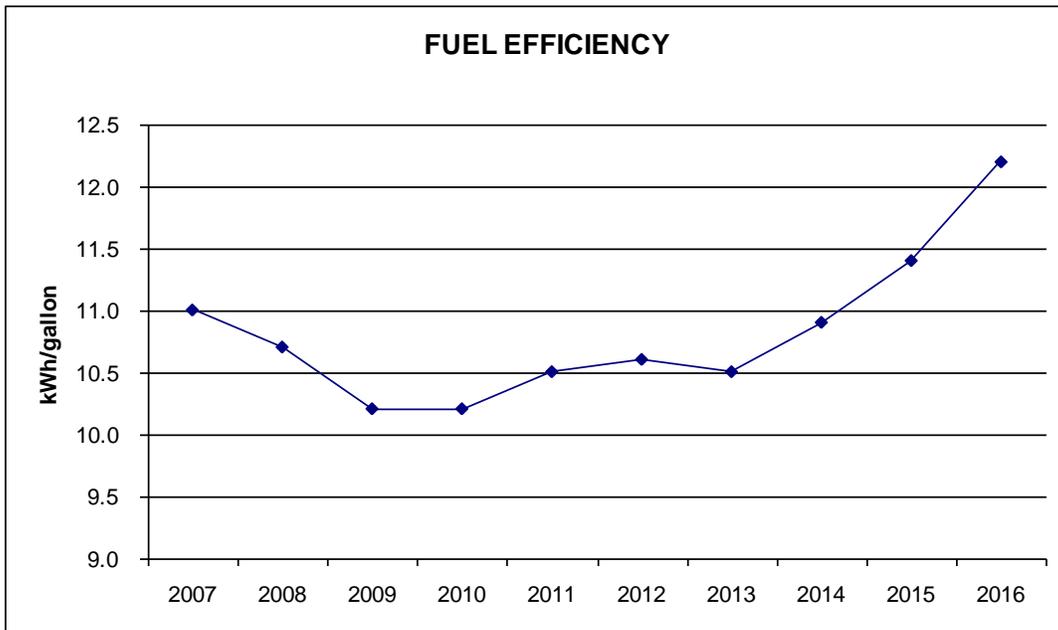
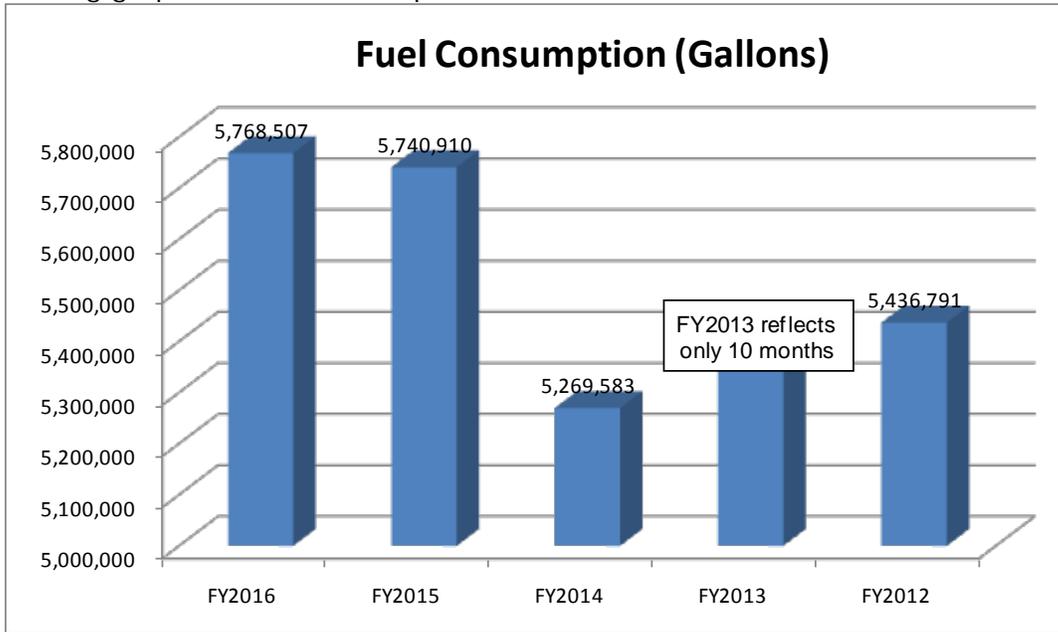
Electric Power Operation Outlook

The projections in the energy outlook normally focus on various factors expected to change the energy market trends and is out of the control by PPUC. The fuel cost has been declining over the last six years from 74% to now 55 % of the total operating cost even though fuel consumption increased. The operating cost for electric power generation, transmission, and distribution also has been declining since 2014, however, a 6% growth rate was realized on electricity demand. PPUC will continue to rely on the average price of the barrel of crude oil to determine the inflation rate used for calculation of the "automatic fuel price adjustment clause" (AFPAC) on a quarterly basis.

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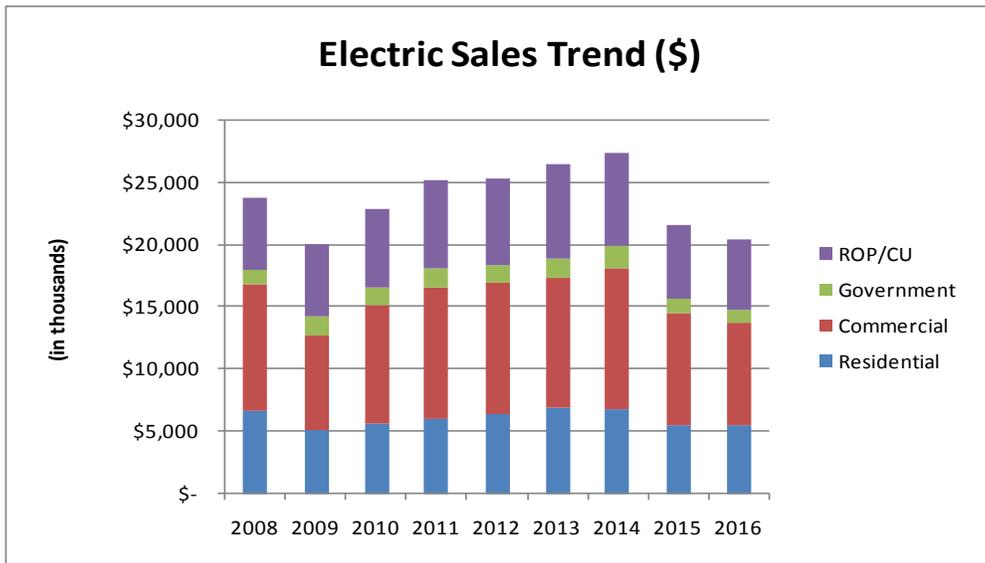
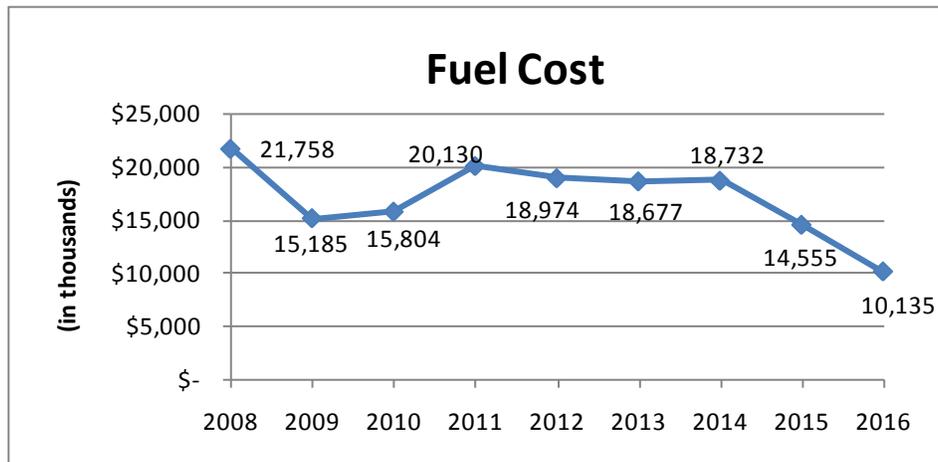
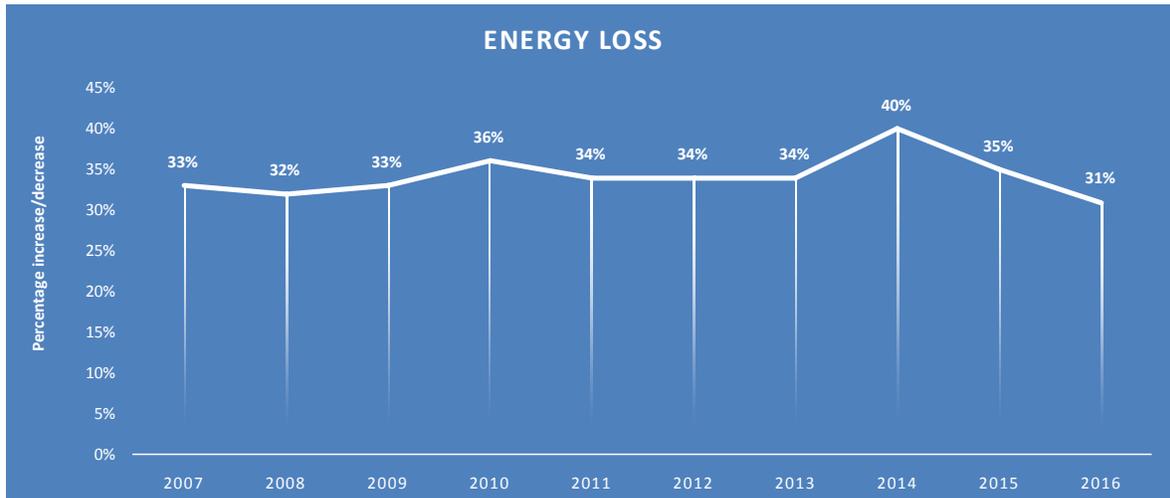
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Years Ended September 30, 2016 and 2015

The following graphs show electric operation trends:



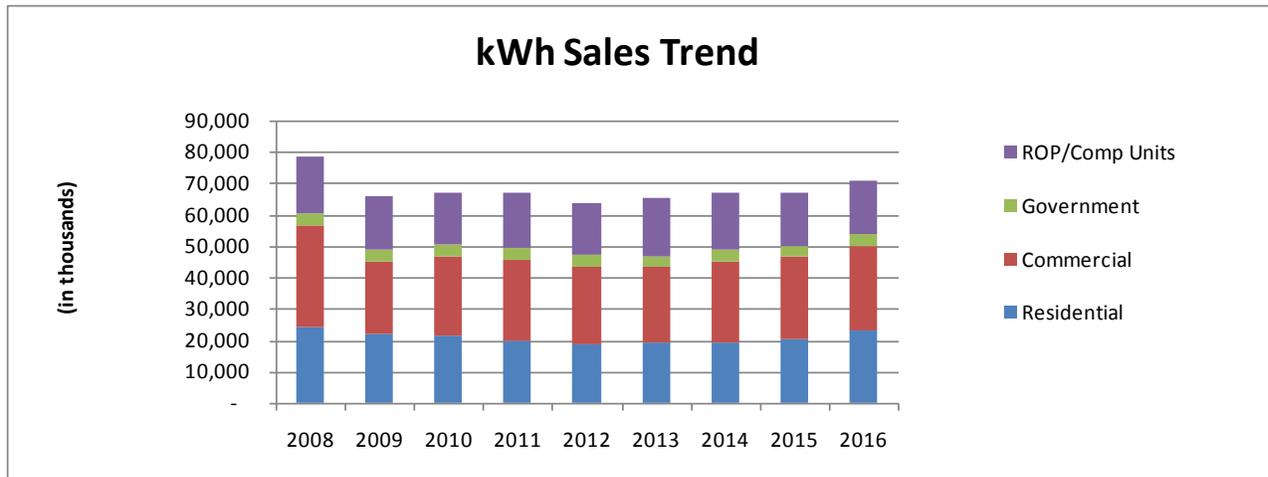
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kWh generation, consumption, and losses

	TARGETS	FY2016	2015	2014	2013	2012
KWH GENERATED		85,717,446	83,110,260	79,254,846	78,786,032	76,813,526
KWH BILLED		70,928,769	66,923,617	66,776,130	65,093,378	63,817,612
KWH LOSSES		14,788,677	16,186,643	12,478,716	13,692,654	12,995,914
Sale Growth (Regression)		6%	0%	3%	2%	-4%
KWH Loss Savings (Increase) %		2%	-4%	2%	0%	3%

PPUC's dependence on fossil fuel is likely to continue for several years due to its size and geographic location. The Palau net metering act approved on January 6, 2012 (RPPL No. 8-9) promotes customer based renewable energy generation for customer's own use. The solar usage in 2016 is 1% of the total kWh billed to the customers as shown on the following table:

EPO					
2016 Solar Usage (KWH) By Category					
	COMM	RES	GOV	ROP	Total / month
Total	<u>349,013</u>	<u>106,362</u>	<u>114,471</u>	<u>345,170</u>	<u>915,016</u>
Total consumption					<u>70,928,766</u>
Percentage of solar usage					1%

PPUC Water and Waste Water Operations

Historically, the water and wastewater utility was operated by the Bureau of Public Works as a Government Department and PPUC, through the Merger Act, has undertaken management of a water and sewer systems and infrastructure dating back to 1987. 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, the Water Sector Improvement Project (WSIP loan of \$16M) and capacity-expansion for the sewer systems of the two densely populated cities of Koror and Airai (roughly \$28M).

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The tariff schedule below was developed to ensure full cost recovery is achieved and that financial resources be conserved and built up for future maintenance and replacement of systems including investments in capital assets. The tariff schedule is expected to be implemented on October 1 of each fiscal year.

Water Rates Tiers/per 1Kgal	2014	FY15	FY16	FY17	FY18
Water -Res (0-5K)	\$ 1.17	\$ 1.47	\$ 1.53	\$ 1.59	\$ 1.65
Water-All Others	\$ 1.91	\$ 4.51	\$ 5.41	\$ 6.49	\$ 6.75
% Incease - Res (0-5k)		26%	4%	4%	4%
% Increase-All		136%	20%	20%	4%

Sewer Rates Tiers/per 1Kgal	2014	FY15	FY16	FY17	FY18
Sewer -Res (0-5K)	\$ 0.30	\$ 0.36	\$ 0.38	\$ 0.39	\$ 0.41
Sewer-All Others	\$ 2.21	\$ 4.13	\$ 4.95	\$ 5.94	\$ 6.18
% Incease - Res (0-5k)		21%	4%	4%	4%
% Increase-All		87%	20%	20%	4%

As shown on the following table, the revenue generated from the above tariff schedule increased by over \$1.1 million or 35%:

WWO Revenues	2014	2015	2016
Residential	922	1,324	1,725
Commercial	1,231	1,766	2,301
Government	63	139	127
ROP/CU	23	88	323
Totals	2,239	3,317	4,476
<i>Percentage Increase</i>		<i>48%</i>	<i>35%</i>

The increase in revenue generation of the water and wastewater operation has allowed for major capital improvement projects to rehabilitate and upgrade water and sewer system plant and systems network to improve efficiency and reduce operational cost. The following projects were implemented and/or in construction phase during 2015 and 2016:

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WWO Major CIPS (2015-2016)	Amount
Billing Systems Upgrade-Able Soft	\$ 60,000
PPUC Share for Water Improvement Project (JICA)	880,000
KB Bridge Overhead Waterline Project	615,900
Metering Program On-going Phase2	50,000
KAWTP Rehab of 1,2,3 & 4 Tanks	123,500
Mengellang Filtration System	94,800
OS EQPB Water Quality Improvement Projects	497,200
Totals	\$ 2,321,400

The following table shows the revenues, expenses and changes in net position of the water and wastewater operations for the past three fiscal years ended September 30, 2014, through September 30, 2016. At the end of the fiscal year, the total assets increased by \$1.6 million or 9% due to the increase in cash and cash equivalents. Further, the total liability increased by over \$6 hundred thousand or 6% due to ADB Koror-Airai Sanitation loan disbursements to the contractors. Net position increased by \$9 hundred thousand or 14% due to the over \$3 million capital contributions and subsidy from the National Government.

(Dollars in Thousands)

WWO	Sept 30, 2016	Sept 30, 2015	Sept 30, 2014	Inc (Dec) 2016	Inc (Dec) 2015
Statements of Net Position					
Current Assets	\$ 6,381	\$ 4,188	\$ 2,019	\$ 2,193	\$ 2,169
Other Assets	-	-	4	-	(4)
Net Utility Plant	12,748	13,389	12,310	(641)	1,079
Total Assets	19,129	17,577	14,333	1,552	3,244
Deferred Outflows from Pension	1,132	1,055	850	77	205
	20,261	18,632	15,183	1,629	3,449
Current Liabilities	3,764	4,323	2,065	(559)	2,258
Other Liabilities	1,910	987	-	923	987
Net Pension Liability	5,759	5,424	5,731	335	(307)
Total Liabilities	11,433	10,734	7,796	699	2,938
Deferred Inflows from Pension	1,099	1,140	464	(41)	676
	12,532	11,874	8,260	658	3,614
Investment in Capital Assets	10,838	12,402	12,310	(1,564)	92
Unrestricted	(3,109)	(5,644)	(5,387)	2,535	(257)
Total Net Position	\$ 7,729	\$ 6,758	\$ 6,923	\$ 971	\$ (165)

The following table shows 43% or \$1.3 million increase in operating revenues since 2015 and it is due to the annual tariff adjustments. The total operating expenses increased by over \$7 hundred thousand or 11% and it is due to operational cost incurred as a result of the 2016 extreme drought state of the emergency declaration (Executive order no. 389).

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(Dollars in Thousands)

WWO	Sept 30, 2016	Sept 30, 2015	Sept 30, 2014	Inc (Dec) 2016	Inc (Dec) 2015
Revenues, Expenses, and Changes in Net Position					
Operating Revenues:					
Water & Wastewater	\$ 4,390	\$ 3,073	\$ 2,239	\$ 1,317	\$ 834
Others	119	156	38	(37)	118
Provision for bad debts	(22)	(155)	(21)	133	(134)
Nonoperating Revenue/Exp	<u>2,725</u>	<u>3,496</u>	<u>1,837</u>	<u>(771)</u>	<u>1,659</u>
Total Revenue	<u>7,212</u>	<u>6,570</u>	<u>4,093</u>	<u>642</u>	<u>2,477</u>
Operating Expenses:					
Water & Wastewater	5,048	4,412	4,767	636	(355)
Depreciation	1,753	1,769	1,766	(16)	3
Admin	<u>820</u>	<u>677</u>	<u>772</u>	<u>143</u>	<u>(95)</u>
Total Operating Expenses	<u>7,621</u>	<u>6,858</u>	<u>7,305</u>	<u>763</u>	<u>(447)</u>
Capital Contributions	<u>1,380</u>	<u>123</u>	<u>1,057</u>	<u>1,257</u>	<u>(934)</u>
Change in Net Position	971	(165)	(2,155)	1,136	1,990
Beginning Net Position	<u>6,758</u>	<u>6,923</u>	<u>9,078</u>	<u>(165)</u>	<u>(2,155)</u>
Ending Net Position	<u>\$ 7,729</u>	<u>\$ 6,758</u>	<u>\$ 6,923</u>	<u>\$ 971</u>	<u>\$ (165)</u>

Water and Wastewater Operation (WWO) Outlook

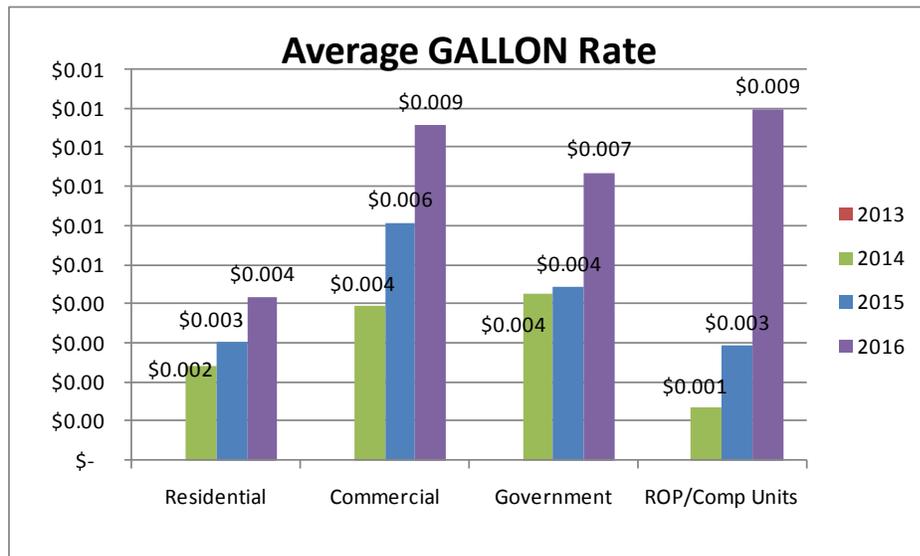
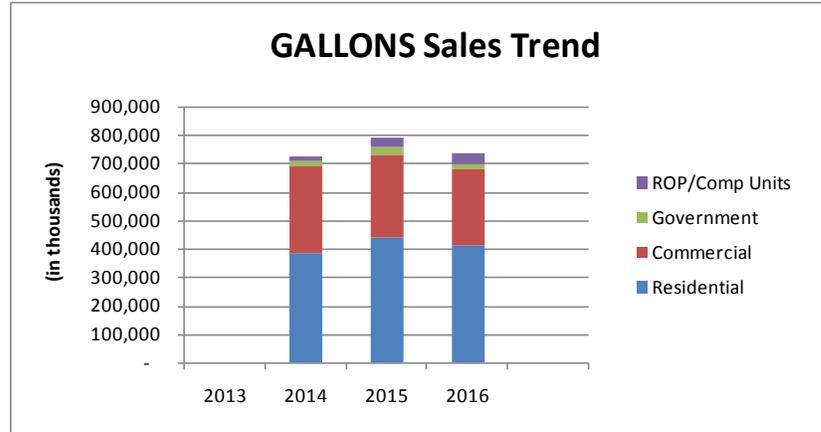
The designed tariff schedule for the purpose of achieving the mandated full cost recovery in subsequent fiscal years, the major rehabilitation and upgrade capital improvements projects implementation, and the continued cost cutting measures is expected to improve WWO financial sustainability, however, may not be sufficient to cover the required ADB KASP loan payments and interest that is scheduled to commence in April 2018. This is an issue that is being deliberated by PPUC and the Leadership.

The following graphs show WWO trends:



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CAPITAL ASSETS and LONG-TERM DEBT

Capital Assets

The following table summarizes PPUC's capital assets by category and accumulated depreciation, and the changes therein for the years ended September 30, 2014 through September 30, 2016. The decrease in the overall corporate capital assets of \$1.5 million was due to asset disposals.

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(Dollars in Thousands)

	Sept 30, 2016	Sept 30, 2015	Sept 30, 2014	Increase (Decrease) 2016	Increase (Decrease) 2015
CAPITAL ASSETS:					
Electric Plants:					
Electric Plants, Koror/Aimeliik	\$ 38,971	\$ 40,027	\$ 41,123	\$ (1,056)	\$ (1,096)
Electric Plants, Outlying States	2,664	2,625	2,626	39	\$ (1)
Total Electric Plants	41,635	42,652	43,749	(1,017)	(1,097)
Accumulated Depreciation	(17,299)	(15,863)	(15,127)	(1,436)	(736)
Net Electric Plant	24,336	26,789	28,622	(2,453)	(1,833)
Transmission & Distribution System					
T&D System, Koror/Aimeliik	17,694	17,552	17,512	142	40
T&D System, Outlying States	2,127	2,199	2,090	(72)	109
Total T&D System	19,821	19,751	19,602	70	149
Accumulated Depreciation	(11,689)	(11,063)	(10,465)	(626)	(598)
Net T&D System	8,132	8,688	9,137	(556)	(449)
Water & Sewer Systems					
Water Infrastructure	23,082	21,761	21,461	1,321	300
Sewer Infrastructure	20,688	20,129	20,129	559	-
Total Water & Sewer Systems	43,770	41,890	41,590	1,880	300
Accumulated Depreciation	(33,600)	(31,988)	(30,341)	(1,612)	(1,647)
Net Water & Sewer Systems	10,170	9,902	11,249	268	(1,347)
Water & Sewer Transmission & Distribution System					
WWO T&D System, Koror/Babeldaob	318	318	318	-	-
Total WWO T&D System	318	318	318	-	-
Accumulated Depreciation	(63)	(32)	-	(31)	(32)
Net WWO T&D System	255	286	318	(31)	(32)
Administrative Equipment					
Buildings	2,613	1,816	1,749	797	67
Heavy Equipment & Vehicles	1,880	1,760	2,597	120	(837)
Tools & Maint Equipment	446	615	1,001	(169)	(386)
Computers & Office Equipment	945	743	870	202	(127)
Total Admin Equipment	5,884	4,934	6,217	950	(1,283)
Accumulated Depreciation	(3,056)	(3,375)	(3,375)	319	-
Net Admin Equipment	2,828	1,559	2,842	1,269	(1,283)
Total Capital Projects in Progress	2,909	2,990	-	(81)	2,990
TOTAL	\$ 48,630	\$ 50,214	\$ 52,168	\$ (1,584)	\$ (1,954)

See note 7 for additional information on PPUC's capital activities.

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Long-Term Debt

The international and local loans were acquired to purchase additional generation capacity and to finance major repairs and generation auxiliary equipment. The long-term soft loan secured by ROP from Asian Development Bank was subsequently loaned to PPUC as per the subsidiary loan agreements dated March 28, 2014. Proceeds will be used to upgrade the Koror sewerage system and construct wastewater treatment plant and sewerage network in Airai. The ADB loan amount as of September 30, 2016 reflects the total amount of the loan proceeds withdrawn and is recognized as long-term debt in the financial statements.

	Original	Sept 30, 2016
International Loan	\$ 7,000,000	\$ 4,200,000
Local Loan	\$ 3,000,000	\$ 2,233,965
ADB Loan	\$ 28,667,179	\$ 1,910,229
TOTAL	\$ 38,667,179	\$ 8,344,194

See note 8 for additional information on PPUC's financing activities.

FUTURE OUTLOOK

Palau is naturally blessed with rich water resources with outstanding natural and cultural resources and has benefited from the strong growth in the tourism sector. Despite this positive outlook, Palau remains vulnerable to other economic disturbance, the impacts of climate change, most especially weather related risks. PPUC's task is to harness, store and safeguard such resources to meet Palau's growing utility 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.

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-WWO continues its effort to provide access for all, to safe water supply and sanitation systems. This strengthened effort is mandated by the leadership to meet service demands from the rapidly growing number of visitors each year.

Republic of Palau 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.

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Years Ended September 30, 2016 and 2015

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, 2015 is set forth in PPUC's report on the audit of financial statements which is dated June 30, 2016.

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 hidechong@ppuc.com or call 488-5320.

PALAU PUBLIC UTILITIES CORPORATION
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Statements of Net Position
September 30, 2016 and 2015

<u>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</u>	<u>2016</u>	<u>2015</u>
Utility plant:		
Depreciable utility plant	\$ 45,721,048	\$ 47,224,386
Non-depreciable utility plant	2,909,003	2,989,592
Net utility plant	<u>48,630,051</u>	<u>50,213,978</u>
Current assets:		
Cash and cash equivalents	15,423,579	8,419,916
Receivables:		
Trade	3,837,755	3,517,460
Affiliate	669,904	366,785
Contracts	127,452	132,949
Other	21,717	418,840
	<u>4,656,828</u>	<u>4,436,034</u>
Less allowance for doubtful accounts	<u>(936,585)</u>	<u>(790,619)</u>
Net receivables	<u>3,720,243</u>	<u>3,645,415</u>
Prepaid expenses	234,077	235,128
Inventory, net	7,528,944	7,861,475
Total current assets	<u>26,906,843</u>	<u>20,161,934</u>
Other non-current assets:		
Contracts receivable, net of current portion	<u>194,865</u>	<u>263,442</u>
Total assets	<u>75,731,759</u>	<u>70,639,354</u>
Deferred outflows of resources from pension	<u>1,974,584</u>	<u>1,645,408</u>
	<u>\$ 77,706,343</u>	<u>\$ 72,284,762</u>
<u>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION</u>		
Net position:		
Net investment in utility plant	\$ 42,469,857	\$ 44,626,037
Unrestricted	4,630,791	(1,902,037)
Total net position	<u>47,100,648</u>	<u>42,724,000</u>
Commitments and contingencies		
Current liabilities:		
Current portion of long-term debt	572,043	559,186
Accounts payable	4,119,711	4,195,423
Accrued expenses	725,392	811,524
Grant advances	571,273	657,263
Customer deposits	959,276	763,429
Total current liabilities	<u>6,947,695</u>	<u>6,986,825</u>
Long-term debt, net of current portion	7,772,151	7,420,758
Net pension liability	<u>13,674,468</u>	<u>13,135,896</u>
Total liabilities	<u>28,394,314</u>	<u>27,543,479</u>
Deferred inflows of resources from pension	<u>2,211,381</u>	<u>2,017,283</u>
	<u>\$ 77,706,343</u>	<u>\$ 72,284,762</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, 2016 and 2015

	2016	2015
Operating revenues:		
Power	\$ 17,908,448	\$ 18,924,686
Water	3,004,280	2,183,972
Wastewater	1,304,738	837,609
Other	1,026,926	927,641
Total operating revenues	23,244,392	22,873,908
Provision for uncollectible receivables	(95,541)	(155,000)
Net operating revenues	23,148,851	22,718,908
Operating expenses:		
Generation - fuel	10,136,046	14,555,200
Depreciation	4,425,371	4,384,591
Generation - other cost	2,356,994	3,778,333
Administration	1,748,036	1,492,469
Distribution and transmission	1,234,603	919,876
Renewable energy	531,586	91,782
Engineering services	328,326	487,612
Water operations	2,798,662	1,921,213
Wastewater operations	421,120	429,964
Total operating expenses	23,980,744	28,061,040
Operating loss	(831,893)	(5,342,132)
Nonoperating revenues (expenses):		
Operating subsidies from the Republic of Palau	2,762,993	3,419,045
Inventory obsolescence recovery	-	181,459
Grants	1,079,356	240,869
Interest income	3,719	4,555
Loss on disposal of utility plant	-	(99,308)
Interest expense	(353,445)	(412,927)
Others	243,697	-
Total nonoperating revenues (expenses), net	3,736,320	3,333,693
Income (loss) before capital contributions	2,904,427	(2,008,439)
Capital contributions:		
Donated capital from the Republic of Palau	52,821	123,552
Capital contributions from the Republic of Palau	1,419,400	-
Change in net position	4,376,648	(1,884,887)
Net position at beginning of year	42,724,000	44,608,887
Net position at end of year	\$ 47,100,648	\$ 42,724,000

See accompanying notes to financial statements.

PALAU PUBLIC UTILITIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	\$ 23,532,143	\$ 23,319,052
Cash payments to suppliers for goods and services	(14,998,034)	(22,443,991)
Cash payments to employees for services	(3,889,494)	(2,723,759)
Net cash provided by (used in) operating activities	4,644,615	(1,848,698)
Cash flows from investing activities:		
Interest income	3,719	4,555
Cash flows from non-capital financing activities:		
Appropriations received from the Republic of Palau	2,762,993	3,419,045
Cash received from grantor agencies	42,000	102,892
Net cash provided by non-capital financing activities	2,804,993	3,521,937
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	923,333	986,898
Principal payment on long-term debt	(559,082)	(548,083)
Interest paid on long-term debt	(396,058)	(381,979)
Capital contributions from the Republic of Palau	1,419,400	-
Acquisition of utility plant	(1,837,257)	(1,753,814)
Net cash used in capital and related financing activities	(449,664)	(1,696,978)
Net change in cash and cash equivalents	7,003,663	(19,184)
Cash and cash equivalents at beginning of year	8,419,916	8,439,100
Cash and cash equivalents at end of year	\$ 15,423,579	\$ 8,419,916
Reconciliation of operating loss to net cash provided by (used in) operating activities:		
Operating loss	\$ (831,893)	\$ (5,342,132)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation	4,425,371	4,384,591
Provision for uncollectible receivables	95,541	155,000
Pension (recovery) expense	(135,078)	123,523
(Increase) decrease in assets:		
Receivables:		
Trade	(269,870)	(152,521)
Affiliate	(303,119)	692,202
Contracts	74,074	(67,565)
Other	397,123	(316,504)
Prepaid expenses	1,051	11,107
Inventory	526,228	820,059
Increase (decrease) in liabilities:		
Accounts payable	(25,712)	(2,600,324)
Accrued expenses	(43,520)	(60,597)
Customer deposits	195,847	289,534
Net pension liability	538,572	214,929
Net cash provided by (used in) operating activities	\$ 4,644,615	\$ (1,848,698)

See accompanying notes to financial statements.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(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 was to establish and operate electrical utility services within the 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 their chains 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.

(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.

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.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

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 the 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, 2016 and 2015.

Net Position

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

Net investment in utility plant – includes utility plant, 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.

Revenue

Sales of electricity, water and wastewater services are recorded as billed to customers on a monthly cycle billing basis. For electricity billings, PPUC factors a variable fuel surcharge into its monthly billings to recover the costs of fuel. 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, 2016 and 2015 were \$1,949,750 and \$1,926,752, respectively.

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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

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.

Pensions

Pensions are required to be recognized and disclosed using the accrual basis of accounting. PPUC recognizes a net pension liability for the defined benefit pension plan in which it participates, which represents PPUC's proportional share of excess total pension liability over the pension plan assets – actuarially calculated – of a cost-sharing multi-employer pension plan, measured one year prior to fiscal year-end and rolled forward. Changes in the net pension liability during the period are recorded as pension expense, or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change, in the period incurred. Those changes in net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience are amortized over the weighted average remaining service life of all participants in the qualified pension plan and recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on qualified pension plan investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense over 5 years beginning with the period in which the difference occurred.

Deferred Outflows of Resources

Deferred outflows of resources represent consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that future time.

Deferred Inflows of Resources

Deferred inflows of resources represent an acquisition of net position that applies to a future period and therefore will not be recognized as an inflow of resources (revenue) until that future time.

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.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

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.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements to correspond with the 2016 financial statement presentation.

New Accounting Standards

During the year ended September 30, 2016, PPUC implemented the following pronouncements:

- GASB 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.
- GASB 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 standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014.

The implementation of these statements did not have a material effect on the accompanying financial statements.

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 No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 Benefit 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 does not believe that the implementation of this statement will have a material effect 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 does not believe that the implementation of this statement will have 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 15, 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.

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(2) 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 of 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.

(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, 2016 and 2015, cash and cash equivalents were \$15,423,579 and \$8,419,916, respectively, and the corresponding bank balances were \$15,709,975 and \$8,520,455, respectively, that are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2016 and 2015, bank deposits of \$750,000 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

PPUC is a subrecipient of federal grants received by the ROP from a U.S. federal agency. PPUC is also a recipient of grants from the Pacific Community for various EPO and WWO projects. Grants received for the years ended September 30, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
U.S. Federal Government	\$ 42,000	\$ 102,892
The Pacific Community	<u>1,037,356</u>	<u>137,977</u>
	\$ <u>1,079,356</u>	\$ <u>240,869</u>

(5) Receivable from a Local Bank

At September 30, 2016 and 2015, PPUC has uninsured deposits of \$1,974,856 and \$2,025,381, respectively, with a bank that went into receivership on November 7, 2006. These deposits were fully provided for with an allowance at September 30, 2016 and 2015.

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(6) Inventory

Inventory at September 30, 2016 and 2015, consists of the following:

	<u>2016</u>	<u>2015</u>
Generation parts and supplies	\$ 5,674,314	\$ 6,466,157
Fuel	2,007,186	2,242,448
Lubricants	53,526	32,346
Chemicals	143,996	10,683
Water distribution parts and supplies	<u>110,805</u>	<u>30,048</u>
	7,989,827	8,781,682
Allowance for slow moving and obsolete inventory	<u>(460,883)</u>	<u>(920,207)</u>
	<u>\$ 7,528,944</u>	<u>\$ 7,861,475</u>

An allowance for slow moving and obsolete inventory of \$414,135 and \$688,541 at September 30, 2016 and 2015, respectively, was provided for generation parts and supplies inventory maintained in the Aimeliik power plant that caught fire in November 2011. In November 2015, PPUC sold \$548,812 of Aimeliik generation parts and supplies inventory for \$274,406.

(7) Utility Plant

Utility plant consists of the following detailed balances at September 30, 2016 and 2015:

	Estimated <u>Useful Lives</u>	Balance at October <u>1, 2015</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2016</u>
Depreciable utility plant:					
Electric plant	3 - 25 years	\$ 41,596,670	\$ 458,449	\$ -	\$ 42,055,119
Water system	20 years	22,155,417	1,321,000	-	23,476,417
Sewer system	20 years	20,128,977	559,432	-	20,688,409
General support equipment	2 - 30 years	24,180,276	583,152	(178,095)	24,585,333
Administrative equipment	2 - 10 years	<u>643,123</u>	<u>-</u>	<u>(18,691)</u>	<u>624,432</u>
		108,704,463	2,922,033	(196,786)	111,429,710
Less accumulated depreciation		<u>(61,480,077)</u>	<u>(4,425,371)</u>	<u>196,786</u>	<u>(65,708,662)</u>
		47,224,386	(1,503,338)	-	45,721,048
Non-depreciable utility plant:					
Construction in progress		<u>2,989,592</u>	<u>3,211,230</u>	<u>(3,291,819)</u>	<u>2,909,003</u>
		<u>\$ 50,213,978</u>	<u>\$ 1,707,892</u>	<u>\$ (3,291,819)</u>	<u>\$ 48,630,051</u>

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(7) Utility Plant, Continued

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2014</u>	<u>Additions and Transfers</u>	<u>Deletions and Transfers</u>	<u>Balance at September 30, 2015</u>
Depreciable utility plant:					
Electric plant	3 - 25 years	\$ 43,748,165	\$ 198,750	\$ (2,350,245)	\$ 41,596,670
Water system	20 years	21,830,513	324,904	-	22,155,417
Sewer system	20 years	20,128,977	-	-	20,128,977
General support equipment	2 - 30 years	24,416,914	631,769	(868,407)	24,180,276
Administrative equipment	2 - 10 years	<u>773,699</u>	<u>42,389</u>	<u>(172,965)</u>	<u>643,123</u>
		110,898,268	1,197,812	(3,391,617)	108,704,463
Less accumulated depreciation		<u>(59,307,921)</u>	<u>(4,384,591)</u>	<u>2,212,435</u>	<u>(61,480,077)</u>
		51,590,347	(3,186,779)	(1,179,182)	47,224,386
Non-depreciable utility plant:					
Construction in progress		<u>577,349</u>	<u>2,809,543</u>	<u>(397,300)</u>	<u>2,989,592</u>
		<u>\$ 52,167,696</u>	<u>\$ (377,236)</u>	<u>\$ (1,576,482)</u>	<u>\$ 50,213,978</u>

(8) Long-Term Debt

	<u>2016</u>	<u>2015</u>
<p>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, due on December 11, 2026, 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.</p>	\$ 4,200,000	\$ 4,600,000
<p>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 due on April 21, 2025 and 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.</p>	2,233,965	2,393,046

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(8) Long-Term Debt, Continued

	<u>2016</u>	<u>2015</u>
On March 28, 2014, PPUC entered into two loans with the ROP to finance sanitation projects in the Koror and Airai areas. The first loan is for \$26,900,000 for twenty years with grace period 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 Special Drawing Rights for twenty years with grace period 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.	<u>1,910,229</u>	<u>986,898</u>
Total long-term debt	8,344,194	7,979,944
Less current maturities	<u>(572,043)</u>	<u>(559,186)</u>
	<u>\$ 7,772,151</u>	<u>\$ 7,420,758</u>

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>
2017	\$ 572,043	\$ 368,059	\$ 940,102
2018	612,369	342,863	955,232
2019	653,732	313,542	967,274
2020	668,898	283,656	952,554
2021	722,577	250,998	973,575
2022 - 2026	3,865,557	738,882	4,604,439
2027 - 2031	898,021	250,769	1,148,790
2032 - 2036	269,699	218,778	488,477
2037 - 2039	<u>81,298</u>	<u>60,847</u>	<u>142,145</u>
	<u>\$ 8,344,194</u>	<u>\$ 2,828,394</u>	<u>\$ 11,172,588</u>

Movements in long-term liabilities for the years ended September 30, 2016 and 2015, are as follows:

	Balance at October 1, <u>2015</u>	<u>Additions</u>	<u>Repayments</u>	Balance at September <u>30, 2016</u>	Balance Due <u>in One Year</u>
Long-term debt	\$ 7,979,944	\$ 923,332	\$ (559,082)	\$ 8,344,194	\$ 572,043
Net pension liability	<u>13,135,896</u>	<u>538,572</u>	-	<u>13,674,468</u>	-
	<u>\$ 21,115,840</u>	<u>\$ 1,461,904</u>	<u>\$ (559,082)</u>	<u>\$ 22,018,662</u>	<u>\$ 572,043</u>

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(8) Long-Term Debt, Continued

	Balance at October 1, 2014	<u>Additions</u>	<u>Repayments</u>	Balance at September 30, 2015	Balance Due in One Year
Long-term debt	\$ 7,541,129	\$ 986,898	\$ (548,083)	\$ 7,979,944	\$ 559,186
Net pension liability	<u>12,920,967</u>	<u>214,929</u>	-	<u>13,135,896</u>	-
	<u>\$ 20,462,096</u>	<u>\$ 1,201,827</u>	<u>\$ (548,083)</u>	<u>\$ 21,115,840</u>	<u>\$ 559,186</u>

(9) Retirement Fund

A. General Information About the Pension Plan:

Plan Description:

PPUC contributes to the Republic of Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost sharing multi-employer plan, which is a component unit of the ROP National Government, providing retirement, security and other benefits to employees, their spouses and dependents, of the ROP, ROP State Governments and ROP agencies, funds and public corporations. The Fund was established pursuant to Republic of Palau Public Law (RPPL) No. 2-26 passed into law on April 3, 1987, and began operations on October 1, 1987. Portions of RPPL No. 2-26 were revised by RPPL 3-21, RPPL 4-40, RPPL 4-49, RPPL 5-30, RPPL 6-37, RPPL 7-56, RPPL 8-10 and RPPL 9-2.

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.

Membership:

The ROP National Government, ROP State Governments and ROP public corporations, quasi-governmental organizations and other public entities of the National and State Governments of ROP, are participating in the Fund. Membership consisted of the following as of October 1, 2013 (the valuation date):

Inactive members currently receiving benefits	1,507
Inactive members entitled to but not yet receiving benefits	1,151
Active members	<u>3,120</u>
Total members	<u>5,778</u>

Summary of the Principal Provisions of the Plan:

Effective date:	October 1, 1987
Plan year:	October 1 through September 30

Eligibility to Participate:

All persons becoming full-time employees of a participating agency before attaining the age of sixty shall become members as a condition of employment.

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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Service:

Vesting Service: Includes membership service and prior service credit.

Membership Service: A year of membership service is earned for a year of service rendered a participating agency. Years of membership service shall be rounded to the nearest one year. Membership service includes accumulated sick leave and vacation leave.

Prior Service Credit: Persons becoming members of the Plan on October 1, 1987 are entitled to Prior Service Credit for services rendered as an employee of participating agencies, the Trust Territory of the Pacific Islands (TTPI), the United States Naval Government after World War II and before the establishment of the TTPI.

Pension Benefits:

Retirement benefits are paid to members who are required, with certain exceptions, to retire no later than their sixtieth birthday or after thirty years of service. A member may retire after his or her fifty-fifth birthday at a reduced pension amount if the member has completed at least twenty years of government employment. A married member of a former member receiving a distribution of benefits under the Pension Fund receives reduced benefit amounts to provide survivors' benefits to his or her spouse. An unmarried member or former member may elect to receive a reduced benefit amount during his or her lifetime with an annuity payable to his or her designated beneficiary. Disability benefits are paid to qualified members for the duration of the disability. Effective May 17, 1996, through RPPL 4-49, members, who have twenty-five years or more of total service, are eligible for retirement regardless of their age and, upon such retirement, are eligible to receive pension benefits at a level established by the Board. Effective July 1, 1999, pursuant to RPPL 4-49 and RPPL 5-30, retirement is mandatory for all members who have thirty years or more of total service and all employees who are sixty years of age or older with certain exceptions. Beginning October 1, 2003, pursuant to RPPL 6-37, mandatory retirement may be delayed for up to five years, by specific exemption by the Board. In December 2008, RPPL 7-56 eliminated early retirement and thirty year mandatory service provisions. These provisions were restored through RPPL 8-10 in October, 2009. On April 30, 2013, RPPL 9-2 eliminated 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.

In accordance with the directives of RPPL 5-7, the Board adopted a resolution which provides that "no person who retires after October 1, 1997, may receive benefits under the Plan unless he or she has contributed to the Plan for at least five years or has made an actuarially equivalent lump sum contribution". In accordance with RPPL 9-2, members who retire after April 30, 2013 must not receive benefits greater than thirty thousand dollars per year. Further, the amount of benefits that a member receives should not be recalculated if the member is re-employed after the member begins receiving benefits under the Fund. Additionally, a member should not receive benefits during the time the member is re-employed subsequent to retirement.

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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Pension Benefits, Continued:

Currently, normal benefits are paid monthly and are two percent of each member's average monthly salary for each year of credited total service up to a maximum of thirty years total service. The average annual salary is the average of the highest three consecutive fiscal years of compensation received by a member during his or her most recent ten full fiscal years of service. For members who have not completed three consecutive fiscal years of employment during his or her most recent ten full fiscal years of service, the average annual salary is the average monthly salary during the term of the member's service multiplied by twelve.

The benefit amount that married members or unmarried members receive, who have elected to designate a beneficiary, is based on the normal benefit amount reduced by the following factors:

<u>Factor</u>	<u>If the Spouse or Beneficiary is:</u>
1.00	21 or more years older than the member
0.95	16 to 20 years older than the member
0.90	11 to 15 years older than the member
0.85	6 to 10 years older than the member
0.80	0 to 5 years younger than the member or 0 to 5 years older than the member
0.75	6 to 10 years younger than the member
0.70	11 to 15 years younger than the member
0.65	16 or more years younger than the member

Surviving beneficiaries of an employee may only receive benefits up to the total present value of the employee's accrued benefit pursuant to RPPL 9-2.

A member that meets the requirements for early retirement and elects to retire on an early retirement date is entitled to receive payment of an early retirement benefit equal to the member's normal retirement benefit reduced according to the following schedule based on the age at which early retirement benefit payments begin:

- 1/12th per year for the first 3 years before age 60;
- plus an additional 1/18th per year for the next 3 years;
- plus an additional 1/24th per year for the next 5 years; and
- plus an additional 1/50th per year for each year in excess of 11 years.

Upon the death of a member or former member with eligible survivors before commencement of the members' normal, early, or late retirement benefits or disability retirement benefits the following shall be payable:

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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Pension Benefits, Continued:

- If the former member is not an employee at his date of death and a spouse or beneficiary survives, the total death benefits payable shall be the actuarial equivalent of the member's present value of accrued benefit.
- If the member is an employee at his date of death and a spouse or beneficiary survives, the total death benefit payable shall be the actuarial equivalent of the greater of 3 times the member's average annual salary or the member's present value of accrued benefits.

Upon the death of a member or former member before commencement of his normal, early, or late retirement benefit or disability retirement benefit leaving no persons eligible for survivor benefits, the following shall be payable:

- If the former member is not an employee at the date of death, a refund of the total amount of contributions made by the member.
- If the member was an employee at the date of death and had completed one year of total service, the estate of the member shall be entitled to a death benefit equal to the greater of three times the member's annual salary or the present value of the member's accrued benefit payable in the form of a single lump sum payment.

Any member who is not otherwise eligible to receive normal, early or late retirement benefits, who shall become totally and permanently disabled for service regardless of how or where the disability occurred, shall be entitled to a disability retirement annuity, provided that he or she is not receiving disability payments from the United States Government or its agencies for substantially the same ailment, and further provided that to be eligible for a disability retirement annuity from a cause unrelated to service, the member shall have had at least ten (10) years of total service credited. The amount of disability retirement annuity shall be an amount equal to the actuarial equivalent at the attained age of the member's present value of accrued benefit and shall be paid in the same form as a normal retirement benefit. Any special compensation allowance received or payable to any member because of disability resulting from accidental causes while in the performance of a specific act or acts of duty shall be deducted from the disability annuity payable by the Plan on account of the same disability.

Member Contributions:

Member contribution rates are established by RPPL No. 2-26 at six percent of total payroll and are deducted from the member's salary and remitted by participating employers. Upon complete separation from service, a member with less than fifteen years membership service may elect to receive a refund of all of his or her contributions. Subsequent changes in the percentage contributed by members may be made through an amendment of the Trust Fund Operation Plan subject to the requirements of Title 6 of the Palau National Code. RPPL 9-2 requires each employee of the National Government and all State Governments, without regard to whether the employee is employed part-time or on a temporary basis, seasonal or an impermanent basis, to contribute to the Fund through payroll deduction.

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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Member Contributions, Continued:

PPUC contributed \$201,827, \$184,349 and \$183,459 to the Fund during the fiscal years 2016, 2015 and 2014, respectively, which was equal to the required contributions for the respective years then ended.

Employer and Other Contributions:

Employers are required to contribute an amount equal to that contributed by employees. Pursuant to RPPL No. 2-26 and RPPL No. 3-21, the Government of the ROP must from time to time contribute additional sums to the Fund in order to keep the Fund on a sound actuarial basis. RPPL 9-2 requires the Government of the ROP to make regular contributions to the Fund equal to the amount contributed by each and every employee of the ROP. Additionally, an excise tax of four percent (4%) is levied against each non-citizen person transferring money out of the ROP. The money transfer tax must be remitted to the Fund.

Actuarial Assumptions:

The total pension liability was determined by an actuarial valuation as of September 30, 2015, for the same measurement date, using the following actuarial assumptions:

Actuarial Cost Method:	Normal costs are calculated under the entry age normal method
Investment Income:	7.5% per year, net of investment expenses
Expenses:	\$300,000 each year
Inflation:	3.0%
Salary Increase:	3.0% per year
Mortality:	RP 2000 Combined Healthy Mortality Table, set forward four years for all members except disability recipients, where the table is set forward 10 years
Termination of Employment:	5% per year prior to age 35; none after age 35
Retirement Age:	100% at age 60
Form of Payment:	Single: Straight life annuity; Married: 100% joint and survivor
Duty vs Non-duty related disability:	100% Duty related

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Notes to Financial Statements
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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Actuarial Assumptions, Continued:

Disability:	<u>Age</u>	<u>Disability</u>
	25	0.21%
	30	0.18%
	35	0.25%
	40	0.35%
	45	0.50%
	50	0.76%
	55	1.43%
	60	2.12%

Pre-retirement Beneficiary Benefit Members: Present value of accrued benefit earned by the member. 80% of the workers are assumed to be married and males are assumed to be 3 years older than their spouses.

Pre-retirement Beneficiary Benefit Former Members: Present value of accrued benefit earned by the member. 80% of the workers are assumed to be married and males are assumed to be 3 years older than their spouses.

Post Retirement Survivor's Benefit: 100% of the benefit the retiree was receiving prior to death. 80% of active workers are assumed to be married when they retire. Males are assumed to be 3 years older than their spouses.

Investment Rate of Return:

The long-term expected rate of return on the Fund's investments of 7.5% was determined using log-normal distribution analysis, creating a best-estimate range for each asset class.

As of September 30, 2015, the arithmetic real rates of return for each major investment class are as follows:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Expected Rate of Return</u>
Cash	3%	4.55%
Equity	61%	6.35%
Governmental fixed income	31%	7.75%
Corporate fixed income	<u>5%</u>	4.00%
	<u>100%</u>	

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(9) Retirement Fund, Continued

A. General Information About the Pension Plan, Continued:

Discount Rate:

The discount rate used to measure the total pension liability was 3.83% at the current measurement date reduced from 4.22% at the prior measurement date. The discount rate was determined using the current assumed rate of return until the point where the plan fiduciary net position is negative. Using the current contribution rates, a negative position happens in 2018 for 2015. For years after 2018, a discount rate of 3.87% is used. This rate is based on the Bond Buyer General Obligation 20-year Municipal Bond Index for September.

Sensitivity of Net Pension Liability to Changes in the Discount Rate:

The following presents PPUC's proportionate share of the net pension liability of the Fund, calculated using the discount rate of 3.83% as well as what the net pension liability would be if it were calculated using a discount rate that is 1.00% lower (2.83%) or 1.00% higher (4.83%) from the current rate.

	1% Decrease <u>2.83%</u>	Current Single Discount Rate Assumption <u>3.83%</u>	1% Increase <u>4.83%</u>
EPO	\$ 9,153,062	\$ 7,915,040	\$ 6,885,841
WWO	<u>6,660,282</u>	<u>5,759,428</u>	<u>5,010,525</u>
	<u>\$ 15,813,344</u>	<u>\$ 13,674,468</u>	<u>\$ 11,896,366</u>

B. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Liability:

As of September 30, 2016 and 2015, PPUC's proportionate share of the ROP net pension liability and PPUC's proportion of the ROP overall liability is as follows:

	<u>Proportionate share of the net pension liability</u>	<u>Proportion of the overall liability</u>
2016:		
EPO	\$ 7,915,040	3.67%
WWO	<u>5,759,428</u>	2.67%
	<u>\$ 13,674,468</u>	
2015:		
EPO	\$ 7,711,821	3.78%
WWO	<u>5,424,075</u>	2.66%
	<u>\$ 13,135,896</u>	

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September 30, 2016 and 2015

(9) Retirement Fund, Continued

B. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions, Continued

Pension Expense:

For the years ended September 30, 2016 and 2015, PPUC recognized pension expense as follows:

	<u>2016</u>	<u>2015</u>
EPO	\$ 298,422	\$ 274,068
WWO	<u>305,921</u>	<u>252,175</u>
	<u>\$ 604,343</u>	<u>\$ 526,243</u>

Deferred Outflows and Inflows of Resources:

At September 30, 2016 and 2015, PPUC reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2016		2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
<u>EPO:</u>				
Changes of assumptions	\$ 649,382	\$ 324,399	\$ 492,945	\$ 444,300
Net difference between projected and actual earnings on pension plan investments	89,790	283,386	-	20,783
Contributions subsequent to the measurement date	103,703	-	98,189	-
Changes in proportion and difference between EPO contributions and proportionate share of contributions	<u>-</u>	<u>504,696</u>	<u>-</u>	<u>412,108</u>
	<u>842,875</u>	<u>1,112,481</u>	<u>591,134</u>	<u>877,191</u>
<u>WWO:</u>				
Changes of assumptions	472,526	236,051	346,711	312,490
Net difference between projected and actual earnings on pension plan investments	65,336	206,207	-	14,617
Contributions subsequent to the measurement date	98,122	-	86,160	-
Changes in proportion and difference between WWO contributions and proportionate share of contributions	<u>495,725</u>	<u>656,642</u>	<u>621,403</u>	<u>812,985</u>
	<u>1,131,709</u>	<u>1,098,900</u>	<u>1,054,274</u>	<u>1,140,092</u>
	<u>\$ 1,974,584</u>	<u>\$ 2,211,381</u>	<u>\$ 1,645,408</u>	<u>\$ 2,017,283</u>

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

Notes to Financial Statements
September 30, 2016 and 2015

(9) Retirement Fund, Continued

B. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions, Continued

Deferred Outflows and Inflows of Resources, Continued:

Deferred outflows resulting from contributions subsequent to measurement date will be recognized as reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions at September 30, 2016 will be recognized in pension expense as follows:

Year Ending September 30,

EPO:		
2017		\$ (115,254)
2018		(115,254)
2019		(114,978)
2020		27,621
2021		(26,928)
Thereafter		<u>(28,516)</u>
		<u>(373,309)</u>
WWO:		
2017		5,013
2018		5,013
2019		5,214
2020		(67,035)
2021		(15,483)
Thereafter		<u>1,965</u>
		<u>(65,313)</u>
		\$ <u>(438,622)</u>

(10) Related Party Transactions

Sale of Utility Services

Utility services of \$5,253,772 and \$5,782,957 were rendered to the ROP for the years ended September 30, 2016 and 2015, respectively. PPUC provides utility services to the ROP at the same rates charged to third parties.

Receivables of \$669,904 and \$366,785 (excluding unbilled receivable of \$456,940 and \$437,460 as of September 30, 2016 and 2015, respectively) are due from the ROP for utility services as of September 30, 2016 and 2015, respectively, and are included in the receivable from affiliate in the accompanying statements of net position. Of these receivables, \$344,432 and \$217,172 as of September 30, 2016 and 2015, respectively, have been outstanding for more than ninety days.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(10) Related Party Transactions, Continued

Loans from the ROP

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

Merger of WWO

As part of the transfer agreement of the WWO (see note 1), the ROP was to transfer all grants, appropriations and authorized loan proceeds to PPUC to cover WWO operating costs. For the years ended September 30, 2016 and 2015, PPUC recognized \$2,266,993 and \$3,419,045, respectively, of WWO operating subsidies from the ROP. In addition, for the year ended September 30, 2016, PPUC recognized \$1,327,648 of capital contributions from the ROP for various WWO projects.

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 the 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. The 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 the ROP. For the years ended September 30, 2016 and 2015, the energy charge incurred by the ROP was \$17,228 and \$24,678, respectively.

PPUC has transactions with Palau Telecoms, a company owned by a board member, for communication services amounting to \$54,500 and \$21,250 for the years ended September 30, 2016 and 2015, respectively. PPUC also has transactions with KJI and Associates, a company owned by a senior manager, for equipment rental amounting to \$138,410 and \$82,945 for the years ended September 30, 2016 and 2015, respectively.

(11) 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.

PALAU PUBLIC UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2016 and 2015

(11) Commitments, Continued

Fuel Supply, Continued

In March 2014, PPUC entered into a 3-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.

(12) 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 13).

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.

PPUC is involved in various legal proceedings arising in the normal course of business. It is the opinion of management, after consulting with its legal counsel, that the ultimate disposition of such legal proceedings will not have a material adverse effect on the financial statements, and therefore no provision has been recorded for potential impact of these contingencies.

The Republic of Palau Civil Service Pension Trust Fund's actuarial valuation has determined that the Fund's fiduciary net position will be negative by 2018 if no changes are made in contribution and/or benefits.

PPUC has been cited for several violations of the Environmental Quality Protection Act by the Environmental Quality Protection Board (EQPB). EQPB has ordered PPUC to pay civil fines totaling \$95,000. Management believes that the civil fines are liabilities of the National Government based on RPPL 9-4, and therefore no provision was recorded in the financial statements for this contingency. PPUC is currently addressing the violations cited by the EQPB.

(13) 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.

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

Notes to Financial Statements
September 30, 2016 and 2015

(14) Dependency on the Republic of Palau

WWO incurred an operating loss of \$3,134,099 and \$3,784,435 for the years ended September 30, 2016 and 2015, respectively. As WWO is primarily funded by the ROP subsidies, management believes that its ability to finance future WWO is dependent on continued adequate funding from the ROP.

(15) Subsequent Events

In December 2016, the Board approved separation of the water and waste water operations. The two divisions will be managed separately.

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

Required Supplemental Information (Unaudited)
Schedule of Proportional Share of the Net Pension Liability
Last 10 Fiscal Years*

	2016	2015	2014
Total Republic of Palau net pension liability	\$ 215,546,176	\$ 204,281,232	\$ 182,080,332
PPUC's proportionate share of the net pension liability	\$ 13,674,468	\$ 13,135,896	\$ 12,920,967
PPUC's proportion of the net pension liability	6.34%	6.43%	7.10%
PPUC's covered-employee payroll**	\$ 3,076,703	\$ 3,022,976	\$ 2,964,580
PPUC's proportionate share of the net pension liability as percentage of its covered employee payroll	444.45%	434.54%	435.84%
Plan fiduciary net position as a percentage of the total pension liability	11.54%	14.01%	16.00%

For the years ended September 30, 2015 and 2014, the covered payroll presented above has been changed from the amounts previously reported of \$2,382,705 and \$2,629,491, respectively.

* This data is presented for those years for which information is available.

** Covered-employee payroll data from the actuarial valuation date with one-year lag.

See Accompanying Independent Auditors' Report.

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

Required Supplemental Information (Unaudited)
Schedule of Pension Contributions
Last 10 Fiscal Years*

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Actuarially determined contribution	\$ 691,501	\$ 683,121	\$ 714,295
Contribution in relation to the actuarially determined contribution	<u>183,373</u>	<u>178,010</u>	<u>178,540</u>
Contribution deficiency	<u>\$ 508,128</u>	<u>\$ 505,111</u>	<u>\$ 535,755</u>
PPUC's covered-employee payroll **	<u>\$ 3,076,703</u>	<u>\$ 3,022,976</u>	<u>\$ 2,964,580</u>
Contribution as a percentage of covered-employee payroll	5.96%	5.89%	6.02%

For the years ended September 30, 2015 and 2014, the actuarially determined contribution presented above has been changed from the amounts previously reported of \$431,505 and \$446,393, respectively.

For the years ended September 30, 2015 and 2014, the covered payroll presented above has been changed from the amounts previously reported of \$2,382,705 and \$2,629,491, respectively.

* This data is presented for those years for which information is available.

** Covered-employee payroll data from the actuarial valuation date with one-year lag.

See Accompanying Independent Auditors' Report.

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

Combining Statement of Net Position
September 30, 2016

<u>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</u>	Electric Power Operations	Water and Wastewater Operations	Eliminations	Total
Utility plant:				
Depreciable utility plant	\$ 34,936,922	\$ 10,784,126	\$ -	\$ 45,721,048
Non-depreciable utility plant	945,015	1,963,988	-	2,909,003
Net utility plant	<u>35,881,937</u>	<u>12,748,114</u>	<u>-</u>	<u>48,630,051</u>
Current assets:				
Cash and cash equivalents	10,506,408	4,917,171	-	15,423,579
Receivables:				
Trade	2,965,609	872,146	-	3,837,755
Affiliate	3,328,056	454,065	(3,112,217)	669,904
Contracts	102,951	24,501	-	127,452
Other	21,233	484	-	21,717
	6,417,849	1,351,196	(3,112,217)	4,656,828
Less allowance for doubtful accounts	<u>(740,784)</u>	<u>(195,801)</u>	<u>-</u>	<u>(936,585)</u>
Net receivables	<u>5,677,065</u>	<u>1,155,395</u>	<u>(3,112,217)</u>	<u>3,720,243</u>
Prepaid expenses	180,581	53,496	-	234,077
Inventory, net	7,274,143	254,801	-	7,528,944
Total current assets	<u>23,638,197</u>	<u>6,380,863</u>	<u>(3,112,217)</u>	<u>26,906,843</u>
Other non-current assets:				
Contracts receivable, net of current portion	194,865	-	-	194,865
Total assets	<u>59,714,999</u>	<u>19,128,977</u>	<u>(3,112,217)</u>	<u>75,731,759</u>
Deferred outflows of resources from pension	842,875	1,131,709	-	1,974,584
	<u>\$ 60,557,874</u>	<u>\$ 20,260,686</u>	<u>\$ (3,112,217)</u>	<u>\$ 77,706,343</u>

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

Net position:				
Net investment in utility plant	\$ 31,631,972	\$ 10,837,885	\$ -	\$ 42,469,857
Unrestricted	7,739,892	(3,109,101)	-	4,630,791
Total net position	<u>39,371,864</u>	<u>7,728,784</u>	<u>-</u>	<u>47,100,648</u>
Commitments and contingencies				
Current liabilities:				
Current portion of long-term debt	572,043	-	-	572,043
Accounts payable	3,928,892	3,303,036	(3,112,217)	4,119,711
Accrued expenses	374,520	350,872	-	725,392
Grant advances	560,059	11,214	-	571,273
Customer deposits	861,053	98,223	-	959,276
Total current liabilities	<u>6,296,567</u>	<u>3,763,345</u>	<u>(3,112,217)</u>	<u>6,947,695</u>
Long-term debt, net of current portion	5,861,922	1,910,229	-	7,772,151
Net pension liability	7,915,040	5,759,428	-	13,674,468
Total liabilities	<u>20,073,529</u>	<u>11,433,002</u>	<u>(3,112,217)</u>	<u>28,394,314</u>
Deferred inflows of resources from pension	1,112,481	1,098,900	-	2,211,381
	<u>\$ 60,557,874</u>	<u>\$ 20,260,686</u>	<u>\$ (3,112,217)</u>	<u>\$ 77,706,343</u>

See accompanying independent auditors' report.

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

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

	Electric Power Operations	Water and Wastewater Operations	Eliminations	Total
Operating revenues:				
Power	\$ 19,806,787	\$ -	\$ (1,898,339)	\$ 17,908,448
Water	-	3,085,327	(81,047)	3,004,280
Wastewater	-	1,304,738	-	1,304,738
Other	907,576	119,350	-	1,026,926
Total operating revenues	<u>20,714,363</u>	<u>4,509,415</u>	<u>(1,979,386)</u>	<u>23,244,392</u>
Provision for uncollectible receivables	(73,488)	(22,053)	-	(95,541)
Net operating revenues	<u>20,640,875</u>	<u>4,487,362</u>	<u>(1,979,386)</u>	<u>23,148,851</u>
Operating expenses:				
Generation - fuel	10,134,675	1,371	-	10,136,046
Depreciation	2,671,939	1,753,432	-	4,425,371
Generation - other cost	2,435,693	-	(78,699)	2,356,994
Administration	972,775	818,294	(43,033)	1,748,036
Distribution and transmission	1,250,986	-	(16,383)	1,234,603
Renewable energy	537,807	-	(6,221)	531,586
Engineering services	334,794	-	(6,468)	328,326
Water operations	-	4,240,395	(1,441,733)	2,798,662
Wastewater operations	-	807,969	(386,849)	421,120
Total operating expenses	<u>18,338,669</u>	<u>7,621,461</u>	<u>(1,979,386)</u>	<u>23,980,744</u>
Operating income (loss)	<u>2,302,206</u>	<u>(3,134,099)</u>	<u>-</u>	<u>(831,893)</u>
Nonoperating revenues (expenses):				
Operating subsidies from the Republic of Palau	496,000	2,266,993	-	2,762,993
Grants	611,958	467,398	-	1,079,356
Interest income	3,217	502	-	3,719
Interest expense	(327,972)	(25,473)	-	(353,445)
Others	228,563	15,134	-	243,697
Total nonoperating revenues (expenses), net	<u>1,011,766</u>	<u>2,724,554</u>	<u>-</u>	<u>3,736,320</u>
Income (loss) before capital contributions	<u>3,313,972</u>	<u>(409,545)</u>	<u>-</u>	<u>2,904,427</u>
Capital contribution:				
Donated capital from the Republic of Palau	-	52,821	-	52,821
Capital contributions from the Republic of Palau	91,752	1,327,648	-	1,419,400
Change in net position	<u>3,405,724</u>	<u>970,924</u>	<u>-</u>	<u>4,376,648</u>
Net position at beginning of year	<u>35,966,140</u>	<u>6,757,860</u>	<u>-</u>	<u>42,724,000</u>
Net position at end of year	<u>\$ 39,371,864</u>	<u>\$ 7,728,784</u>	<u>\$ -</u>	<u>\$ 47,100,648</u>

See accompanying independent auditors' report.

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

Combining Statement of Cash Flows
Year Ended September 30, 2016

	Electric Power Operations	Water and Wastewater Operations	Eliminations	Total
Cash flows from operating activities:				
Cash received from customers	\$ 21,215,357	\$ 4,248,265	\$ (1,931,479)	\$ 23,532,143
Cash payments to suppliers for goods and services	(12,461,837)	(4,467,676)	1,931,479	(14,998,034)
Cash payments to employees for services	(2,067,385)	(1,822,109)	-	(3,889,494)
Net cash provided by (used in) operating activities	6,686,135	(2,041,520)	-	4,644,615
Cash flows from investing activities:				
Interest income	3,217	502	-	3,719
Cash flows from non-capital financing activities:				
Appropriations received from the Republic of Palau	496,000	2,266,993	-	2,762,993
Cash received from grantor agencies	42,000	-	-	42,000
Net cash provided by non-capital financing activities	538,000	2,266,993	-	2,804,993
Cash flows from capital and related financing activities:				
Proceeds from issuance of long-term debt	-	923,333	-	923,333
Principal payment on long-term debt	(559,082)	-	-	(559,082)
Interest paid on long-term debt	(335,627)	(60,431)	-	(396,058)
Capital contributions from the Republic of Palau	91,752	1,327,648	-	1,419,400
Acquisition of utility plant	(1,099,014)	(738,243)	-	(1,837,257)
Net cash (used in) provided by capital and related financing activities	(1,901,971)	1,452,307	-	(449,664)
Net change in cash and cash equivalents	5,325,381	1,678,282	-	7,003,663
Cash and cash equivalents at beginning of year	5,181,027	3,238,889	-	8,419,916
Cash and cash equivalents at end of year	\$ 10,506,408	\$ 4,917,171	\$ -	\$ 15,423,579
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ 2,302,206	\$ (3,134,099)	\$ -	\$ (831,893)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation	2,671,939	1,753,432	-	4,425,371
Provision for uncollectible receivables	73,488	22,053	-	95,541
Pension recovery	(16,451)	(118,627)	-	(135,078)
(Increase) decrease in assets:				
Receivables:				
Trade	(258,726)	(11,144)	-	(269,870)
Affiliate	(4,869)	(346,157)	47,907	(303,119)
Contracts	68,095	5,979	-	74,074
Other	385,213	11,910	-	397,123
Prepaid expenses	(16,120)	17,171	-	1,051
Inventory	725,165	(198,937)	-	526,228
Increase (decrease) in liabilities:				
Accounts payable	434,430	(412,235)	(47,907)	(25,712)
Accrued expenses	(14,172)	(29,348)	-	(43,520)
Customer deposits	132,718	63,129	-	195,847
Net pension liability	203,219	335,353	-	538,572
Net cash provided by (used in) operating activities	\$ 6,686,135	\$ (2,041,520)	\$ -	\$ 4,644,615

See accompanying independent auditors' report.

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

Schedule of Revenues and Expenses (Before Eliminations)
Year Ended September 30, 2016

	<u>Electric Power Operations</u>	<u>Water and Wastewater Operations</u>
Operating revenues:		
Commercial	\$ 8,190,554	\$ 2,265,910
Residential	5,442,873	1,877,476
Government	1,035,326	130,941
Republic of Palau and component units	5,138,034	115,738
Other	<u>907,576</u>	<u>119,350</u>
	<u>\$ 20,714,363</u>	<u>\$ 4,509,415</u>
Operating expenses:		
Personnel costs:		
Salaries and wages	\$ 1,922,232	\$ 1,724,246
Employee benefits	257,585	240,230
Other employee benefits	60,165	45,011
Pension expense adjustment - GASB 68	<u>186,768</u>	<u>216,725</u>
Total personnel costs	2,426,750	2,226,212
Generation - fuel	10,134,675	1,371
Depreciation	2,671,939	1,753,432
Repairs and maintenance	2,258,176	1,083,482
Communication	144,007	51,562
Utilities	128,024	1,851,362
Supplies	106,157	45,431
Gas and oil	91,894	83,035
Insurance	78,271	16,987
Small tools and equipment	67,768	35,670
Professional services	59,677	57,696
Rent	30,138	41,449
Water treatment chemicals	-	176,702
Others	<u>141,193</u>	<u>197,070</u>
	<u>\$ 18,338,669</u>	<u>\$ 7,621,461</u>

See accompanying independent auditors' report.