PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

For The Years Ended December 31, 2014 and 2013

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

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December 31, 2014

INDEPENDENT AUDITORS' REPORT

Board of Directors
Palau National Communications Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statements of net position as of December 31, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and 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 of 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 of material misstatement.

An audit includes 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 PNCC's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements referred above present fairly, in all material respects, the financial position of PNCC as of December 31, 2014 and 2013, 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 and budgetary comparison information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits 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 Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Palau National Communications Corporation's financial statements as a whole. The Schedules of Functional Expenses are presented for purposes of additional analysis and are not a required part of the financial basic statements. These Schedules are the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated May 15, 2015, on our consideration of PNCC's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Burger Comer Magliari

BURGER COMER MAGLIARI
Koror, Republic of Palau
May 15, 2015

This section of Palau National Communications Corporation's (PNCC) annual financial report presents the analysis of its financial performance during the fiscal year ended December 31, 2014 with comparisons to prior years ended December 31, 2012 and 2013. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section.

BUSINESS OVERVIEW

OUR SERVICES

PNCC is a full-service telecommunications provider that offers nationwide coverage for all services, including Local and Long Distance Telephone, GSM Mobile, Internet, and Digital TV. The 5-year subscriber trend shows PalauNet (Internet) is clearly the most popular service with an increase of 82% since 2010, followed by GSM mobile which grew by 32%.

The growth in PalauNet subscriptions was mainly due to the increase in HomeNet sign-ups. Internet revenue continues to grow with more customers using HomeNet and prepaid Internet access to Wi-Fi Hotspots.

PNCC's build-up of GSM coverage and system capacity over the past few years has accelerated usage of mobile telephone services.

Five Year Growth Trend
2010 – 2014

						Growth (2010 v. 2014)	
Year End December 31	**2010**	**2011**	**2012**	**2013**	**2014**	**#**	**%**
GSM Mobile	**14,512**	**15,445**	**17,151**	**17,945**	**19,114**	**4,602**	**32%**
Postpaid	987	1,095	1,405	1,509	1,733	746	76%
Prepaid	13,525	14,350	15,746	16,436	17,381	3,856	29%
Fixed Line (Telephone)	**6,976**	**6,916**	**7,299**	**7,263**	**7,149**	**173**	**2%**
Business/Government	2,796	2,800	3,162	3,166	3,108	312	11%
Residential	4,180	4,116	4,137	4,097	4,041	(139)	-3%
PalauNet (Internet)	**1,087**	**1,297**	**1,709**	**1,805**	**1,974**	**887**	**82%**
Dialup	827	754	781	726	649	(178)	-22%
DSL	192	220	269	240	275	83	43%
Web Package	1	2	4	3	3	2	200%
Domestic Leased Line	19	22	26	54	62	43	226%
Intl Private Line	1	1	-	-	-	(1)	-100%
Wi-Fi Hotspots	47	72	93	116	150	103	219%
HomeNet	-	226	536	666	835	835	0%
						-	
Digital TV	**3,500**	**3,587**	**3,653**	**3,751**	**3,763**	**263**	**8%**
Single Dwelling	2,704	2,779	2,719	2,940	2,956	252	9%
Multi Units	796	808	934	811	807	11	1%

FINANCIAL HIGHLIGHTS

STATEMENTS OF NET POSITION

December 31, 2014, 2013, and 2012

	2014	2013	2012
ASSETS			
Current Assets			
Cash	$ 680,101	$ 449,356	$ 442,762
Restricted cash and cash equivalents	3,724,627	3,854,182	3,661,576
Receivables, net	1,295,714	992,373	1,484,220
Inventories	175,407	164,472	183,068
Deposit	180,000	-	-
Prepaid expenses	45,717	55,457	70,884
Total current assets	**6,101,566**	**5,515,840**	**5,842,510**
Investments	612,157	592,534	500,000
Other noncurrent assets	51,550	51,550	51,550
Plant and equipment, net	20,785,952	17,591,664	19,078,062
Total Assets	**$ 27,551,225**	**$ 23,751,588**	**$ 25,472,122**
LIABILITIES AND NET POSITION			
Current liabilities			
Current portion of long-term debt	$ 1,674,848	$ 1,653,076	$ 1,572,477
Current portion of contract payable	1,695,600	-	-
Accounts payable	157,390	195,944	78,626
Payable to carriers, net	75,925	69,967	349,097
Accrued expenses	673,806	520,828	606,078
Unearned revenues	143,458	107,620	130,049
Total current liabilities	4,421,027	2,547,435	2,736,327
Contract payable, net of current portion	2,228,400		
Note payable, net of current portion	23,999,889	25,690,244	27,131,154
Customer deposits	698,345	707,676	673,133
Total liabilities	**31,347,662**	**28,945,355**	**30,540,614**
Commitment and contigencies			
Net position:			
Invested capital assets, net of related debt	(4,888,785)	(9,751,656)	(9,625,569)
Restricted - Debt service reserve	3,724,627	3,854,182	3,661,576
Unrestricted	(2,632,279)	703,707	895,501
Total net position	**(3,796,437)**	**(5,193,767)**	**(5,068,492)**
Total Liabilities and Net Position	**$ 27,551,225**	**$ 23,751,588**	**$ 25,472,122**

At end of 2014, total assets decreased by $ 124,363 due mainly to depreciation and retirement of obsolete assets.

Net position was reduced by $ 1,397,330 net income at end of 2014.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
December 31, 2014

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years ended December 31, 2014, 2013, and 2012

	2014	2013	2012
Operating revenues			
GSM Mobile	$ 4,289,077	$ 3,906,624	$ 3,939,731
PalauNet	2,936,599	2,412,483	2,224,011
Local	1,487,049	1,524,516	1,449,268
Digital TV	1,451,216	1,424,674	1,352,538
Long Distance	1,339,854	1,380,808	1,445,065
Miscellaneous	89,659	63,314	242,294
Provision for doubtful accounts	(249,587)	(274,923)	(778,427)
Total Operating Revenues	**11,343,867**	**10,437,496**	**9,874,480**
Operating expenses			
Plant specific operations	3,912,022	3,937,832	3,584,420
Depreciation	2,128,506	2,371,825	2,543,071
Customer service operations	1,245,085	1,216,396	1,279,855
Corporate operations	1,078,695	1,250,275	1,244,004
Plant non-specific operations	279,170	305,370	345,371
Total Operating Expenses	**8,643,478**	**9,081,698**	**8,996,721**
Earnings from operations	**2,700,389**	**1,355,798**	**877,759**
Nonoperating income (expenses):			
Unrealized gain on investments	22,387	88,097	-
Realized gain on investments	-	9,411	-
Interest income	596	8,732	12,312
Interest (expense)	(1,433,267)	(1,420,094)	(1,328,295)
Income (loss) on investments	10,181	(4,974)	-
Gain (loss) on retirement of equipment	1,806	(33,450)	(598,780)
Other income (expense)	95,238	(128,795)	22,582
Total nonoperating income (expenses), net	**(1,303,059)**	**(1,481,073)**	**(1,892,181)**
Change in net position	1,397,330	(125,275)	(1,014,422)
Net position at beginning of year	(5,193,767)	(5,068,492)	(4,054,070)
Net position at end of year	$ (3,796,437)	$ (5,193,767)	$ (5,068,492)

Total operating revenues increased by 9% from $10.4 million in 2013 to $11.3 million in 2014. Increase in total revenues is attributable to the increase in the revenues from GSM Mobile operations.

Operating expenses decreased by $438,220 in 2014 over 2013 is primarily attributable to some fixed assets which is fully depreciated in 2013 and the management effort for cost cutting measure in corporate office.

Earnings from operation increased by 99% from $1,355,798 in 2013 to $2,700,389 in 2014.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
December 31, 2014

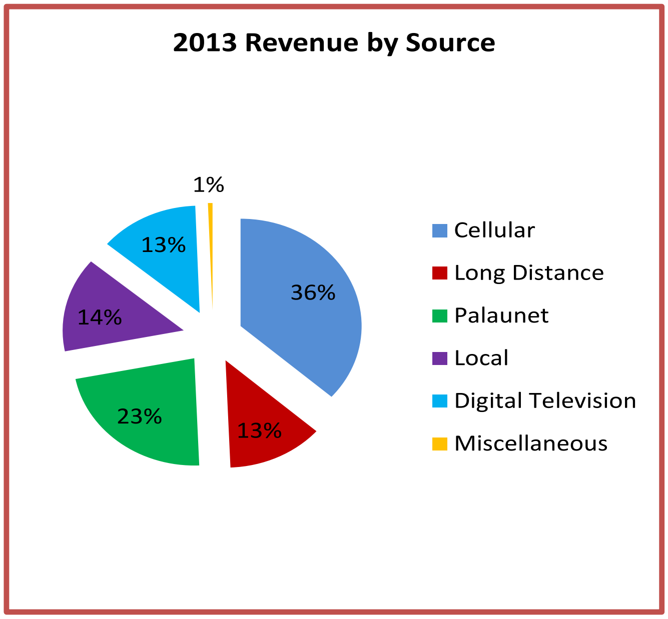
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

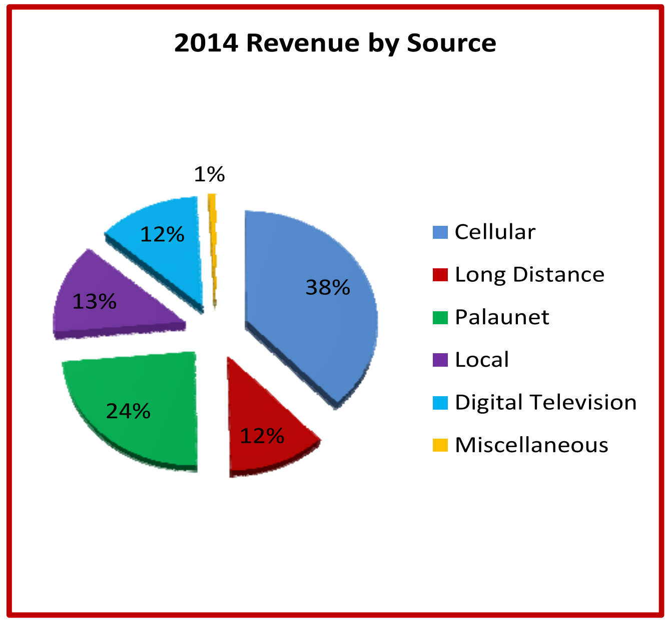
	2014	2013	Increase / (Decrease) Dollar	Increase / (Decrease) Percent	2012
Operating revenues	$ 11,343,867	$ 10,437,496	$ 906,371	8.7%	$ 9,874,480
Operating expenses	(8,643,478)	(9,081,698)	438,220	-4.8%	(8,996,721)
Operating income	2,700,389	1,355,798	1,344,591	99.2%	877,759
Nonoperating income (expenses)	(1,303,059)	(1,481,073)	178,014	-12.0%	(1,892,181)
Change in net position	$ 1,397,330	$ (125,275)	$ 1,272,055	-1015.4%	$ (1,014,422)

REVENUE BY SOURCE

Revenue Source	2014	2013	Increase / (Decrease) Dollar	Increase / (Decrease) Percent	2012
Cellular	$ 4,289,077	$ 3,906,624	$ 382,453	9.8%	$ 3,939,731
Long Distance	1,339,854	1,380,808	(40,954)	-3.0%	1,445,065
Palaunet	2,936,599	2,412,483	524,116	21.7%	2,224,011
Local	1,487,049	1,524,516	(37,467)	-2.5%	1,449,268
Digital Television	1,451,216	1,424,674	26,542	1.9%	1,352,538
Miscellaneous	89,659	63,314	26,345	41.6%	242,294
Provision for doubtful accts	(249,587)	(274,923)	25,336	-9.2%	(778,427)
Total	**$ 11,343,867**	**$ 10,437,496**	**906,371**	**8.7%**	**$ 9,874,480**

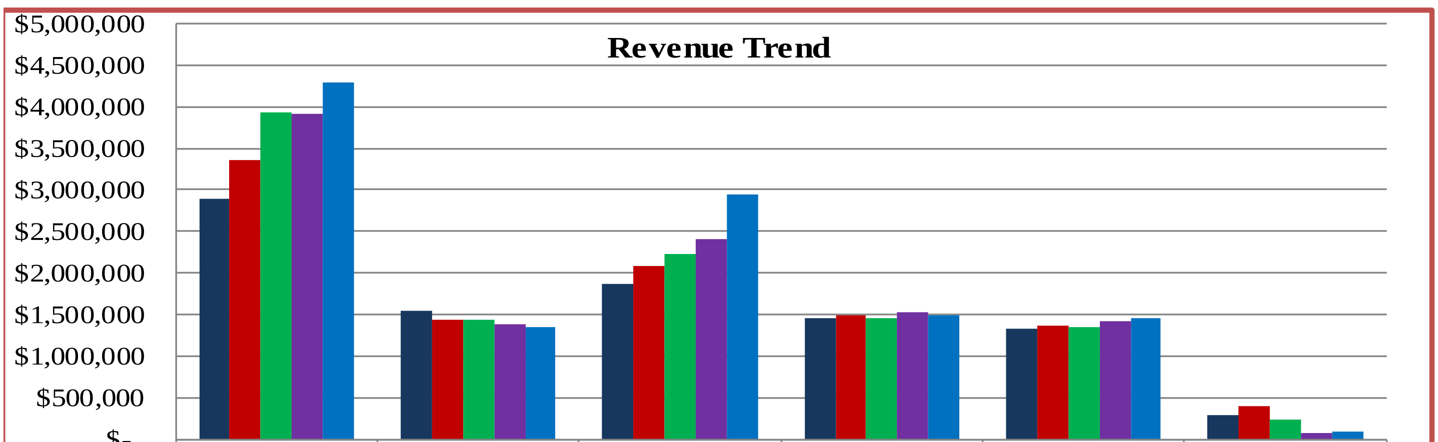
Cellular operation has consistently contributed the highest source of revenue and continues to grow over the past five years. PNCC has seen the declining of long distance and miscellaneous revenues as its internet operation improves. The revenues from local telecommunications and digital television have been fairly consistent over the past five years.





Summarized in the chart above are the major revenue sources. For 2014, the cellular operations contributed 38% of the total operating revenues.

The chart below shows the change in revenues by source over the past five years.



	Celluar	Long Distance	Palaunet	Local	DTV Television	Misc
2010	$2,894,006	$1,541,586	$1,866,938	$1,445,873	$1,322,768	$283,715
2011	$3,359,520	$1,429,346	$2,077,983	$1,499,031	$1,362,971	$396,491
2012	$3,939,731	$1,445,065	$2,224,011	$1,449,268	$1,352,538	$242,294
2013	$3,906,624	$1,380,808	$2,412,483	$1,524,516	$1,424,674	$63,314
2014	$4,289,077	$1,339,854	$2,936,599	$1,487,049	$1,451,216	$89,659

SUMMARY OF STRATEGIC PLANNING AND FINANCIAL RESULTS

PNCC Strategic Planning Process

The PNCC's 5-year Mid-Term Business Plan (2014-2018), developed with expert assistance of Mr. Akira Maeda in 2013 provides a road map for financial sustainability of the corporation. Based on the Business Plan, PNCC procured and began the implementation of 3G platform in order to further improve and advance its GSM cellular services. Work is continuing to improve 3G service and expand beyond service areas of Koror and Airai.

Summary of Financial Results for 2014

As shown in the above for the Statement of Revenues, Expenses and Changes in Net Position, PNCC's 2014 revenue increased by 9% over the previous year. The positive change in net position at end of 2014 helps reduce PNCC cumulative deficit by $1,397,330.

- Telephony: The revenue for fixed line service continues to decline due to demand shrinkage for long-distance calls via Fixed-line.
- PalauNet: The revenue increased (by 22% vs. 2013), reflected by the demand increases for Homenet and Wi-Fi Hotspots.
- PalauCel: The revenue maintained strong growth (10% per annum) for 2014 reflected by the brisk demand for the Pre-paid services introduction of 3G service toward the end of 2014.
- DTV: With introduction of live feed for U.S. channels, Digital TV service realized a 2% increase in revenue over 2013.

CONTACTING PNCC'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of PNCC's finances and to demonstrate PNCC's transparency and accountability for the money it receives. The Management's Discussion and Analysis for the year ended December 31, 2014 is set forth in the report on the audit of PNCC. The discussion and analysis explains the major factors impacting the 2014 financial statements. If you have questions or need additional information, please contact the Chief Financial Officer at the Palau National Communications Corporation, P.O. Box 99, Koror, Republic of Palau 96940, or e-mail leot@palaunet.com or call 587-9000.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

FINANCIAL SECTION

For The Years Ended December 31, 2014 and 2013

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Net Position
December 31, 2014 and 2013

ASSETS

	2014	2013
Current assets:		
Cash (Notes 2, 3, 6 and 9)	$ 680,101	$ 449,356
Receivables: (Notes 2, 6 and 9)		
Trade	3,729,498	4,404,722
Related party (Note 5)	340,650	412,226
Carrier, net	424,400	285,304
Other receivable	219,129	104,386
Allowance for doubtful accounts (Note 2)	(3,417,963)	(4,214,265)
Total receivables, net	1,295,714	992,373
Inventories, net (Notes 2 and 6)	175,407	164,472
Deposit	180,000	-
Prepaid expenses	45,717	55,457
Total current assets	2,376,939	1,661,658
Investments (Notes 2 and 3)	612,157	592,534
Restricted cash and cash equivalents (Notes 2, 3, 6 and 9)	3,724,627	3,854,182
Other noncurrent assets (Note 2)	51,550	51,550
Capital assets, net (Notes 2, 4, 6)	20,785,952	17,591,664
	$ 27,551,225	$ 23,751,588

LIABILITIES AND NET POSITION

	2014	2013
Current liabilities:		
Current portion of long-term debt (Notes 6 and 9)	$ 1,674,848	$ 1,653,076
Current portion of contract payable (Notes 7 and 9)	1,695,600	-
Accounts payable (Note 9)	157,390	195,944
Payable to carriers, net (Note 9)	75,925	69,967
Accrued expenses (Notes 2 and 9)	673,807	520,828
Unearned revenues (Notes 2 and 9)	143,458	107,620
Customer deposits (Notes 2 and 9)	698,345	707,676
Total current liabilities	5,119,373	3,255,111
Contract payable, net of current portion (Notes 7 and 9)	2,228,400	-
Note payable, net of current portion (Notes 6 and 9)	23,999,889	25,690,244
Total liabilities	31,347,662	28,945,355
Commitments and contingencies (Note 8)		
Net position (Note 2):		
Net investment in capital assets	(4,888,785)	(9,751,656)
Restricted for:		
Debt service and reserve	3,724,627	3,854,182
Unrestricted	(2,632,279)	703,707
Total net position	(3,796,437)	(5,193,767)
	$ 27,551,225	$ 23,751,588

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Revenues, Expenses and Changes in Net Position
For The Years Ended December 31, 2014 and 2013

	2014	2013
Operating revenues (Note 6):		
Cellular	$ 4,289,077	$ 3,906,624
Palaunet	2,936,599	2,412,483
Local	1,487,049	1,524,516
Digital television	1,451,216	1,424,674
Long distance	1,339,854	1,380,808
Miscellaneous	89,659	63,314
Provision for doubtful accounts	(249,587)	(274,923)
Total operating revenues	11,343,867	10,437,496
Operating expenses:		
Plant specific		
Operations	3,912,022	3,937,832
Depreciation (Note 4)	2,128,506	2,371,825
Customer service	1,245,085	1,216,396
Corporate office	1,078,695	1,250,275
Plant non-specific operations	279,170	305,370
Total operating expenses	8,643,478	9,081,698
Operating income	2,700,389	1,355,798
Nonoperating income (expense):		
Other income (expense), net	95,238	(128,795)
Unrealized gain on investments	22,387	88,097
Income (loss) on investments	10,181	(4,974)
Gain (loss) on retirement of equipment	1,806	(33,450)
Interest income	596	8,732
Realized gain on investments	-	9,411
Interest expense (Note 6)	(1,433,267)	(1,420,094)
Total nonoperating income (expense), net	(1,303,059)	(1,481,073)
Change in net position	1,397,330	(125,275)
Net position at beginning of year	(5,193,767)	(5,068,492)
Net position at end of year	$ (3,796,437)	$ (5,193,767)

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION

(A Component Unit of the Republic of Palau)

Statements of Cash Flows

For The Years Ended December 31, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	$ 11,170,734	$ 10,944,420
Cash payments to suppliers for goods and services	(5,541,996)	(5,543,054)
Cash payments to employees	(1,267,697)	(1,511,616)
Net cash provided by operating activities	4,361,041	3,889,750
Cash flows from capital and related financing activities:		
Additions to capital assets	(5,076,864)	(918,877)
Withdrawals from restricted cash and cash equivalents	129,555	(192,606)
Interest paid	(1,433,267)	(1,420,094)
Long-term contract payable	3,924,000	-
Repayment of long-term note payable	(1,668,583)	(1,360,311)
Net cash used for capital and related financing activities	(4,125,159)	(3,891,888)
Cash flows from investing activities:		
Interest income	10,181	8,732
Proceeds from sale and maturities of investment securities	275,170	221,484
Income (loss) on investment	1,806	(4,974)
Purchase of investment securities	(292,294)	(216,510)
Net cash provided by investing activities	(5,137)	8,732
Net increase in cash	230,745	6,594
Cash at beginning of year	449,356	442,762
Cash at end of year	$ 680,101	$ 449,356

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Cash Flows, Continued
For The Years Ended December 31, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 2,700,389	$ 1,355,798
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,128,506	2,371,825
Provision for doubtful accounts	249,587	274,923
Allowance for uncollectible account write-off	(1,106,215)	(143,920)
Other income (expense), net	(130,208)	(128,795)
(Increase) decrease in assets:		
Receivables:		
Trade	675,224	(147,158)
Related party	71,576	(35,805)
Carriers, net	(139,096)	515,047
Other receivable	(114,743)	28,760
Inventories	(10,935)	18,596
Deposit	(180,000)	-
Prepaid expenses	9,740	15,427
Increase (decrease) in liabilities:		
Accounts payable	21,772	117,318
Payable to carriers, net	5,958	(279,130)
Accrued expenses	152,979	(85,250)
Customer deposits	(9,331)	34,543
Unearned revenues	35,838	(22,429)
Net cash provided by operating activities	$ 4,361,041	$ 3,889,750

See accompanying notes to financial statements.

(1) Organization

Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau (ROP), was created on August 23, 1982, under the provisions of the Republic of Palau Public Law (RPPL) 1-40. The law created a wholly owned government corporation managed by five (5) 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 PNCC is to establish and operate communications services as a communication common carrier within the ROP. PNCC conducts its operations on land and in buildings provided by the National Government of the ROP. PNCC has four divisions: PNCC, PNCC Wireless (Wireless), Digital Cable Television (DTV) formerly known as Island Cable Television (ICTV), and Palaunet, which provides local and long distance telephone services, cellular telecommunications services and equipment, digital cable television services, and internet services, respectively, within the ROP.

(2) Summary of Significant Accounting Policies

The accounting policies of PNCC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

A. Basis of Presentation

The financial statements of PNCC have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental entities. In 2012, PNCC adopted Government Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement identifies and consolidates accounting and financial reporting provisions that apply to state and local governments. Prior to the issuance of Statement No. 62, PNCC applied the standards and principles outlined in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary and Other Governmental Entities that Use Proprietary Fund Accounting*. GASB Statement No. 62, which supercedes Statement No. 20, is the primary resource for accounting guidance and principles.

(2) Summary of Significant Accounting Policies, Continued

A. Basis of Presentation, Continued

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

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

- Management's discussion and analysis

- Basic financial statements, including a statement of net position, statement of revenues, expenses and changes in net position and a statement of cash flows using the direct method; and

- Notes to financial statements

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

Net investment in capital assets:

Capital assets net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction or improvements of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should be included in this component of net position. At December 31, 2014 and 2013, PNCC does not have deferred outflows of resources or deferred inflows of resources that need to be included in this component of net position.

Restricted:

Restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. At December 31, 2014 and 2013, PNCC does not have deferred outflows of resources, and deferred inflows of resources that needed be included in this component of restricted net position.

(2) Summary of Significant Accounting Policies, Continued

A. Basis of Presentation, Continued

PNCC's component of net position, continued

Restricted net position, continued

The PNCC's restricted net position categories are as follows:

Nonexpendable: Net position subject to externally imposed stipulations that require PNCC to maintain them permanently. At December 31, 2014 and 2013, PNCC does not have any nonexpendable net position.

Expendable: Net position whose use by PNCC is subject to externally imposed stipulations that can be fulfilled by actions of the PNCC pursuant to those stipulations or release of those stipulations by the passage of time.

Assets that have been assigned as collateral for the Rural Utilities Service (RUS) loan are classified as restricted.

Unrestricted:

Net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties. At December 31, 2014 and 2013, PNCC does not have deferred outflows of resources or deferred inflows of resources that need to be included in this component of net position.

B. Measurement Focus and Basis of Accounting

Measurement focus refers to timing of recognition, that is, when revenues and expenditures, expenses, and transfers and assets, deferred outflows of resources, liabilities and deferred inflows of resources are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The accrual basis of accounting is utilized by proprietary funds. Under the accrual method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred. PNCC uses the accrual basis of accounting.

(2) Summary of Significant Accounting Policies, Continued

B. Measurement Focus and Basis of Accounting, continued

PNCC maintains a chart of accounts in accordance with the Uniform System of Accounts for telephone companies of the United States of America Federal Communication Commission's Rules, and in conformity with accounting principles generally accepted in the United States of America (GAAP).

C. Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for uncollectible accounts receivable and management's estimate of depreciation expense which is based on estimated useful lives of the respective assets. The allowance for uncollectible accounts receivable is determined based on management estimates. While management believes the amount is adequate, the ultimate uncollectible balance may differ from the amounts provided.

D. Budget

In accordance with the ROP Code, the Board of Directors of PNCC adopts an annual budget on a proprietary fund basis and the budget is used as a management tool throughout the accounting cycle. All operating and capital expenditures and revenues are identified in the budgeting process. PNCC's budget is presented to the Olbiil Era Kelulau (OEK) for its review and comments no later than sixty days (60 days) before the budget's effective date (November 1). Pursuant to regulation of the ROP, after PNCC has repaid the RUS loan, PNCC is required to submit a detailed and itemized budget to the OEK for its approval no later than sixty (60) days before it is to take effect.

Throughout the year, PNCC monitors and evaluates expenditure levels and patterns. The Board of Directors may authorize revisions to the budget based on the availability of financial resources. Formal budget revisions are authorized in the same manner as original budget submissions.

The supplementary information in the Management's Discussion and Analysis in pages 4 to 9 includes PNCC's analysis of the significant variations and major factors impacting the 2014 and prior years within its five-year strategic plan and the currently known reasons for those significant variations that PNCC expects to affect its liquidity or ability to provide future services.

(2) Summary of Significant Accounting Policies, Continued

E. New Accounting Standards

During the year ended December 31, 2013, PNCC implemented the following GASB Statements:

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources or deferred inflows of resources to ensure consistency in financial reporting. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The provisions of Statement 63 did not have a material effect on the accompanying financial statements of PNCC.

In April 2012, GASB issued Statement No. 66, *Technical Corrections—2012*—which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this Statement are effective for periods beginning after December 15, 2012. Management does not believe that the implementation of this statement had a material effect on the financial statements of PNCC.

Recent Pronouncements

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial report of most pension plans, and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, which establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement No. 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement No. 68 are effective for fiscal years beginning after June 15, 2014. Management is evaluating the impact that the implementation of these statements will have on the financial statements of PNCC.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. The Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. Government combinations include mergers, acquisitions and transfers of operations. The Statement requires assets acquired and liabilities assumed to be measured at carrying values in an acquisition. The Statement requires disclosures to be made about government combinations and disposals of government operations so that financial statement users can evaluate the nature and financial effects of those combinations. The Statement is effective for financial statements for periods beginning after December 15, 2013 and should be applied on a prospective basis. Early application is encouraged. Management has not yet determined the effect of implementation of these Statements on the financial statements of PNCC.

(2) Summary of Significant Accounting Policies, Continued

E. New Accounting Standards, Continued

Recent Pronouncements, Continued

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in this Statement are effective for fiscal years beginning after June 15, 2013. Earlier application is encouraged. Management does not believe that the implementation of this Statement will have a material impact on PNCC’s financial statements.

In November 2013 GASB issued Statement No. 71, *Accounting and Financial Reporting for Pensions*. This Statement amends paragraph 137 of Statement 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68. Management does not believe that the implementation of this Statement will have a material impact on PNCC’s financial statements.

In February 2015 GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. This Statement requires additional analysis of fair value if the volume or level of activity for an asset or liability has significantly decreased. It also requires identification of transactions that are not orderly. This Statement requires measurement at acquisition value (an entry price) for donated capital assets, donated works of art, historical treasures, and similar assets and capital assets received in a service concession arrangement. This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged. Management does not believe that the implementation of this Statement will have a material impact on PNCC’s financial statements.

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position

Cash

Cash in the statement of cash flows includes cash on hand and cash in checking and savings accounts.

Restricted Cash and Cash equivalents

Restricted cash and cash equivalents, including amounts restricted for repayment of debt owed to Rural Utilities Service (RUS), amounts restricted for contracts approved by the RUS and RUS revenues, are separately classified in the Statements of Net Position.

Receivables and Allowance for Doubtful Accounts

PNCC grants credit on an unsecured basis to individuals, businesses and governmental entities that are situated in the Republic of Palau, the United States of America, Japan and the Territory of Guam.

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 evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expense.

Receivables and Allowance for Doubtful Accounts, Continued

An analysis of the change in allowance for doubtful accounts for the years ended December 31, 2014 and 2013 is as follows:

	2014	2013
Balance, beginning of year	$ 4,214,265	$ 4,083,262
Current year provisions	249,587	274,923
Accounts written-off	(1,045,889)	(143,920)
Balance, end of year	$ 3,417,963	$ 4,214,265

Inventories

Inventories comprise telecommunication equipment, parts and cables and are stated at the lower of cost (average cost method) or market.

(2) Summary of Significant Accounting Policies, Continued

Investments

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the PNCC. As of December 31, 2014 and 2013, there were no investments in any one issuer that exceeded five percent (5%) of total investments.

PNCC has formal policies in place as of December 31, 2014 and 2013 to address investment risks. The following investment policy governs the investment of assets of PNCC:

General:

- Any restrictions set forth by applicable law governing limits, size, or quality of investments, if more stringent that those of this investments policy, will be the governing restriction.
- U.S. and non-U.S. common stocks, ADRs (American Depository Receipts), convertible bonds, preferred stocks, fixed-income securities, mutual funds and short-term securities are permissible investments.
- No individual security of any issuer, other than that of the United States Government, shall constitute more than 10% (at cost) of any Investment Manager's portfolio.
- Holdings of any issuer shall constitute no more than 5% of the outstanding securities of such issuer.
- Investments in a registered mutual fund managed by the Investment Manager are subject to prior approval of the Board of Directors.
- The following securities and transactions are not authorized: letter stock and other unregistered securities; non-negotiable securities; commodities or other commodity contracts; and short sales or margin transactions. Options and futures are restricted, except by petition to the Board of Directors for approval.

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Investments, Continued
Equities:

- Consistent with the desire to maintain broad diversification, allocations to any economic or industry sector should not be excessive. Comparisons to peer group characteristics will be used to evaluate and to assure consistency of each manager's stated strategy and style.

- Equity holdings shall be restricted to readily marketable securities of corporations that are actively traded on the major exchanges and over the counter.

- The Investment Managers shall have the discretion to invest a portion of the assets in cash reserves when they deem appropriate. However, the Investment Managers will be evaluated against their peers on the performance of the total funds under their direct management.

- Common stock and preferred stock of any institution or entity created or existing under the laws of the United States of America or any state, district, territory, or District of Columbia, or of any foreign country are permissible investments.

U.S. Fixed Income:

- All fixed income securities (with the exception of U.S. Treasury or Agency securities which are unrated) shall have a Moody's, Standard & Poor's and/or a Fitch's credit quality rating of no less than "BBB".

- No more than 20% of the market value of the portfolio shall be rated less than single "A" quality, unless the Investment Manager has specific written authorization. Total portfolio quality (capitalization weighted) shall maintain an "A" minimum rating.

Cash/Cash Equivalents:

- The following investments will be permitted:

    1. U.S. Government obligations, U.S. Government agency obligations, and U.S Government instrumentality obligations.

    2. Commercial Paper: All commercial paper issuers must maintain an "A-1" rating by Standard & Poor's Corporation and a "P-1" rating by Moody's Investor Service and be issued by corporations having total assets in excess of one billion dollars ($1,000,000,000).

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Investments, Continued

3. Certificates of Deposit: All certificate of deposit issuers must have a minimum capital of ten million dollars ($10,000,000).

4. Repurchase Agreements: Repurchase agreements must be collateralized with either: (1) U.S. Treasury or Agency Securities with a market value of 102%, marked to market daily; or (2) money market instruments which meet the qualifications of the Statement and with a market value of 102%, marked to market daily.

5. Money Market Funds: Money Market Funds must be registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940.

- No single issue shall have a maturity of greater than one (1) year.

- The money market funds must have an average maturity of less than one (1) year.

GASB Statement No. 40 requires entities to provide information about the credit risk associated with their investments by disclosing the credit quality ratings.

Capital Assets

Capital assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation expense is provided using the straight-line method over the estimated useful lives of the respective assets. Major improvements and betterments which increase the usefulness and efficiency or prolong the life of the asset are capitalized, while the costs of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, are charged to expense as these costs are incurred.

Depreciation expense for all capital assets is provided for on the straight-line basis over the following estimated useful lives:

	Estimated Useful Lives
Telecommunications equipment	5 - 25 years
Central office equipment	3 - 17 years
Building and general support equipment	3 - 30 years
Cable television equipment	2 - 20 years
Wireless equipment	3 - 15 years
Furniture and fixtures	5 - 10 years
Vehicles	6 years

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Review of Carrying Value of Capital Assets for Impairment

PNCC reviews the carrying value of capital assets for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors. The management of PNCC does not believe that any impairment exists for the years ending December 31, 2014 and 2013.

Capitalization of Interest

Interest is capitalized by PNCC when it is determined to be material. PNCC capitalizes interest in accordance with GASB Statement No. 62. Interest is capitalized for costs incurred on funds used to construct or acquire property, plant and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life.

Other noncurrent assets

Other noncurrent assets represent refundable deposits related to PNCC's subscription of television channels and programs for its digital television services. At December 31, 2014 and 2013, refundable deposit was $51,550 in each year.

Compensated Absences

Compensated absences are those absences for which employees will be paid, such as annual vacation leave and health (sick) leave. PNCC recognizes all vested vacation leave benefits accrued by its employees when earned. Employees are credited annual leave with pay of 80, 120, and 160 hours per year depending upon their length of service with PNCC. An employee cannot carry over to the following calendar year accumulated annual vacation leave in excess of 80 hours for 5 to 9 years of service, and 120 hours for employees with over 10 years of service. However, a carryover of additional annual leave may be allowed upon request and approval by the Management when it is determined to be in the interest of PNCC. At December 31, 2014 and 2013 accrued annual leave totaled $79,745 and $63,350, respectively, and is included in the Statements of Net Position as a component of accrued expenses. At December 31, 2014 and 2013, all compensated absences are current.

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Compensated Absences, continued

For the years ended December 31, 2014 and 2013, annual vacation leave taken totaled $103,400 and $124,218, respectively, and is included in the Statements of Revenues, Expenses and Changes in Net Position as a component of operating expenses. No liability is recorded for non-vesting accumulating rights to receive health or sick pay benefits.

Unearned revenues

Unearned revenues consist of cash payments received from customers for which goods or services has not been earned or realized, and prepaid long distance sales in which actual traffic minutes were used and processed after the reporting period. At December 31, 2014 and 2013, unearned revenues from prepaid telecom billings were $143,458 and $107,620, respectively. Management has not determined the unearned revenue from prepaid long distance sales.

Customer deposits

Customer deposits consist of subscriber deposits, installation fees and amounts received for related services and subscriptions to be provided in future periods. PNCC's requirement of customer deposit amount varies depending on the type of service or subscription applied for. Deposits are eligible for refunding after twelve (12) consecutive months of prompt payment history. If a deposit is held on an account at the time services are terminated, the deposit will be applied to the unpaid balance and a refund check is issued for the remainder. Refunds are not automatic; the customer must request a refund. There is no interest paid on customer deposits. At December 31, 2014 and 2013, customer deposits were $698,345 and $707,676, respectively.

Advertising Costs

Advertising costs are expensed as incurred. At December 31, 2014 and 2013, advertising costs totaled $5,980 and $26,418, respectively, and are included as a component of customer service operations expense reported in the Statements of Revenues, Expenses and Changes in Net Position.

Retirement Plan, Republic of Palau Civil Service Pension Trust Fund

PNCC contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multi-employer pension plan established and administered by the Republic of Palau.

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Retirement Plan, Republic of Palau Civil Service Pension Trust Fund, continued

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents of the Republic of Palau, Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations. Benefits are paid monthly and are two percent (2%) of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established.

Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and are matched dollar-for-dollar by the employer. PNCC contributed $87,393, $97,249 and $94,708 to the Fund for the years ended December 31, 2014, 2013 and 2012, respectively, and is included in the functional expenses and allocated between plant specific operations, corporate operations, customer service operations, and plant non-specific operations reported in the Statements of Revenues, Expenses and Changes in Net Position.

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

The Fund utilizes the actuarial cost method termed "level aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 7.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement; and (c) members are assumed to retire at the earlier of age 60 or at 30 years of service.

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

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Retirement Plan, Republic of Palau Civil Service Pension Trust Fund, Continued

Based on the actuarial valuation of the Fund as of October 1, 2013 the actuarial valuation determined the unfunded pension benefit obligation as follows:

Accrued liability as of October 1, 2013 for:

Active participants	$ 82,099,216
Inactive participants with vested deferred benefits	3,323,468
Participants in pay status	61,865,857
Total accrued liability	147,288,541
Market value of assets	(34,261,206)
Unfunded accrued liability	$ 113,027,335
Funded ratio (ratio of assets to liabilities)	23.3%

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net position available for benefits by sponsor.

Medical and Life Insurance Benefit

In April 2010, the Republic of Palau (ROP) enacted RPPL No. 8-14 "*The National Healthcare Financing Act*". The law requires each resident in the Republic of Palau to have coverage for healthcare costs. The law establishes a national Medical Savings Fund and a Health Insurance System in the ROP.

In October 2010, in compliance with the requirements of RPPL 8-14, PNCC began withholding from its employees 2.5% of gross earnings each pay period, with a matching employer share (a 5% combined contribution) for remittance to the ROP Social Security Administration that administers the Medical Savings Fund and Palau Health Insurance. For the years ended December 31, 2014, 2013 and 2012, PNCC's employer's share paid to the Social Security Administration was for these costs was $42,596, $43,384 and $44,425, respectively, and is included as a component of payroll burden in the Schedule of Functional Expenses in page 43.

(2) Summary of Significant Accounting Policies, Continued

F. Assets, Liabilities and Net Position, Continued

Taxes

Based on the enactment of RPPL 1-40, PNCC is exempt from all national and state non-payroll taxes or fees.

Operating and Non-operating Revenues and Expenses

PNCC's Statements of Revenues, Expenses and Changes in Net Position distinguishes between operating and non-operating revenues and expenses. Operating revenues and expenses result from exchange transactions associated directly from the operation and maintenance of telecommunication services and equipment, cellular telecommunication operations, DTV operations, and Palaunet operation services. Nonexchange revenues and expenses results from nonrecurring income and costs such as interest income and expense are reported as non-operating revenues.

Net Position

Net position is the residual of assets and deferred outflows of resources over liabilities and deferred inflows of resources in a statement of financial position. PNCC had no deferred outflows or inflows of resources at December 31, 2014 and 2013. Therefore, the PNCC'S net position represents the residual interest in PNCC's assets after liabilities. At December 31, 2014 and 2013, PNCC's net position is negative, meaning that total liabilities exceeded total assets.

Net position consists of three components: net investment in capital assets net of related debt; restricted - expendable and nonexpendable; and unrestricted. Net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of the related debt. Net position is reported as restricted when constraints are imposed by third parties or enabling legislation. At December 31, 2014 and 2013, PNCC had a deficit net position totaling $3,796,437 and $5,193,767, respectively.

When program expenses are incurred, where there are both restricted and unrestricted resources available to finance the program, expenses are first applied to restricted resources before using unrestricted resources.

(3) Deposits and Investments Risk

Deposits

GASB Statement No. 3 requires government entities to categorize deposits to give an indication of the level of credit risk assumed by the entity at year-end based on the following categories:

(3) Deposits and Investments Risk, Continued

Deposits, continued

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

At December 31, 2014 and 2013, the carrying amount of PNCC's cash balances was $680,101 and $449,356, respectively. The corresponding bank balances as of December 31, 2014 and 2013 were $909,694 and $955,731, respectively. From these deposits, $379,546 and $580,738, respectively, were subject to coverage by the Federal Deposit Insurance Corporation (FDIC) with the remaining balance exceeding insurable limits. PNCC does not require collateralization of bank accounts, and therefore, deposits in excess of FDIC insurance coverage are uncollateralized.

Investments

Governmental accounting standards require that the investments reported as of the balance sheet date be categorized according to level of credit risk. The level of credit risk is defined as follows:

- Category 1 - insured and registered for which the securities are held by PNCC or by its agent in PNCC's name;
- Category 2 - uninsured and registered for which the securities are held by the broker's or dealer's trust department or agent in PNCC's name; and
- Category 3 - uninsured and unregistered for which the securities are held by the broker or dealer or by its trust department or agent but not in PNCC's name.

Restricted Cash and Cash Equivalents

PNCC's restricted cash and cash equivalents must comply with Section 22 of the Pledge of Assets and Agreement to Create Trust (Rural Electrification Administration "REA" Loan Agreement), wherein PNCC is required to maintain a funded reserve in such amount that the balance of the funds covered by the First Note shall at no time be less than the outstanding principal and unpaid interest of the First Note.

(3) Deposits and Investments Risk, Continued

Restricted Cash and Cash Equivalents, continued

The reserve shall be maintained in accordance with a plan submitted to and approved in writing by the Administrator of REA (now the Rural Utilities Service or "RUS"). The balance of the reserve shall comply with this section no later than one year from the date of this first advance of funds covered by the First Note. Thereafter, PNCC must maintain such compliance continuously. Assets held in the reserve must be held by a bank or institution or other depository whose funds are insured by the Federal government and shall consist of (a) Federal government securities held in PNCC's name; (b) other securities by an institution whose senior unsecured debt obligations are rated in any of the top three categories by a nationally recognized rating organization; or (c) cash.

All of PNCC's restricted cash and cash equivalents with a market value of $3,724,627 and $3,854,182 as of December 31, 2014 and 2013, respectively, are placed in short-term money market mutual funds held by the Bank of New York Mellon, an FDIC insured financial institution. Although the money market mutual fund is not insured by the FDIC, this mutual fund portfolio consists of US Treasury bills and obligations guaranteed by the US Department of the Treasury as well as repurchase agreements which are fully collateralized by such obligation. This mutual fund has a weighted average maturity of 45 days and is rated AAAm by Standard and Poor's and AAA-mf by Moody's.

Investments

PNCC's Emergency Reserve Fund (the Fund) has been invested with Morgan Stanley Smith Barney, which holds the investments in PNCC's name. The PNCC's Board of Directors is responsible for directing and monitoring the investment management of the Fund. The Board of Directors currently has no specific projected contribution or distribution requirements for the Fund. The Board of Directors shall, from time to time, designate accumulated reserves to be contributed to and managed under the auspices of the Fund. The Fund will be invested in such a way that adequate funds can be made available within a short period of time, should a distribution need arise.

(3) Deposits and Investments Risk, Continued

Investments, Emergency Reserve Fund Continued

At December 31, 2014 and 2013, PNCC's investment portfolios at fair value are as follows:

	2014			2013		
	Allocation		Market	Allocation		Market
	Actual	Policy	Value	Actual	Policy	Value
Fixed income securities:						
Corporate bonds			$ 63,023			$ 67,260
U.S. Treasury			53,479			46,869
Federal agencies			25,079			24,832
Total fixed income	23%	30%	141,581	23%	30%	138,961
Equity securities:						
U.S. equities	56%	50%	340,371	55%	50%	324,791
Non-U.S. equities	10%	10%	60,442	11%	10%	65,601
Total equity securities			400,813			390,392
Cash and cash equivalents	11%	10%	69,763	11%	10%	63,181
Total investments	100%	100%	$612,157	100%	100%	$592,534

At December 31, 2014 and 2013, PNCC's fixed income securities had the following ratings and maturities:

As of December 31, 2014

		Investment maturities (in years)				Rating	
Investment type	Fair Value	Less than 1	1-5	6-10	More than 10	Moody	Standard & Poor
Corporate bonds	$ 3,997	$ -	$ 3,997	$ -	$ -	A3	A
Corporate bonds	4,635	-	4,635	-	-	BAA1	BBB+
Corporate bonds	4,515	-	-	4,515	-	BAA1	A-
Corporate bonds	3,780	-	-	3,780	-	BAA3	BBB
Corporate bonds	4,176	-	-	4,176	-	A2	A+
Corporate bonds	7,365	-	-	7,365	-	BAA3	BBB-
Corporate bonds	4,970	-	-	4,970	-	BAA3	BBB
Corporate bonds	12,302	-	-	12,302	-	A3	A-
Corporate bonds	7,916	-	-	7,916	-	A2	A
Corporate bonds	4,306	-	-	4,306	-	A2	A-
Corporate bonds	5,061	-	-	-	5,061	A1	AA+
Federal agencies	25,079	-	25,079	-	-	AAA	AA+
U.S. Treasury	20,289	-	20,289	-	-	AAA	No rating
U.S. Treasury	20,926	-	-	20,926	-	AAA	No rating
U.S. Treasury	12,264	-	-	-	12,264	AAA	No rating
Total	$ 141,581	$ -	$ 54,000	$ 70,256	$ 17,325		

(3) Deposits and Investments Risk, Continued

Investments, Emergency Reserve Fund Continued

As of December 31, 2013

		Investment maturities (in years)				Rating	
Investment type	Fair Value	Less than 1	1-5	6-10	More than 10	Moody	Standard & Poor
Corporate bonds	$ 8,669	$ -	$ 8,669	$ -	$ -	A3	A
Corporate bonds	8,770	-	8,770	-	-	BAA1	BBB+
Corporate bonds	4,815	-	4,815	-	-	A1	AA
Corporate bonds	4,482	-	-	4,482	-	BAA1	A
Corporate bonds	7,930	-	-	7,930	-	BAA3	BBB
Corporate bonds	4,045	-	-	4,045	-	A2	A+
Corporate bonds	4,063	-	-	4,063	-	BAA2	BBB-
Corporate bonds	4,733	-	-	4,733	-	BAA1	BBB
Corporate bonds	3,756	-	-	3,756	-	A3	A-
Corporate bonds	7,492	-	-	7,492	-	A2	A
Corporate bonds	3,840	-	-	-	3,840	A1	A
Corporate bonds	4,665	-	-	-	4,665	A1	AA+
Federal agencies	24,832	-	24,832	-	-	AAA	AA+
Governments	20,973	-	20,973	-	-	AAA	No rating
Governments	17,337	-	-	17,337	-	AAA	No rating
Governments	8,559	-	-	-	8,559	AAA	No rating
Total	$ 138,961	$ -	$ 68,059	$ 53,838	$ 17,064		

(4) Capital Assets

Summarized below are PNCC's capital assets for the years ended December 31, 2014 and 2013.

	Balance at December 31, 2013	Additions	Transfers/ Retirements	Balance at December 31, 2014
Regulated capital assets				
Cables and transmission lines	$ 26,696,999	$ 252,563	$ -	$ 26,949,562
Transmission equipment	9,337,672	386,093	-	9,723,765
Buildings	8,857,170	-	-	8,857,170
Central office equipment	4,027,010	-	-	4,027,010
General support equipment	2,209,110	53,670	-	2,262,780
Customer premises wiring and equipment	1,272,159	49,139	-	1,321,298
Vehicles	616,144	137,205	(51,496)	701,853
Furniture and fixtures	34,013	-	-	34,013
Regulated capital assets, at cost	53,050,277	878,670	(51,496)	53,877,451
Accumulated depreciation	(39,928,740)	(1,546,114)	50,090	(41,424,764)
Regulated capital assets, at net book value	13,121,537	(667,444)	(1,406)	12,452,687
Non-regulated capital assets				
Cable television	3,031,491	127,734	(83,528)	3,075,697
Cellular	5,176,262	42,738	-	5,219,000
Palaunet	1,063,301	92,421	-	1,155,722
Non-regulated capital assets, at cost	9,271,054	262,893	(83,528)	9,450,419
Accumulated depreciation	(5,366,506)	(582,392)	-	(5,948,898)
Non-regulated capital assets, at net book value	3,904,548	(319,499)	(83,528)	3,501,521
Construction in progress	565,579	4,266,165	-	4,831,744
Total	$ 17,591,664	$ 3,279,222	$ (84,934)	$ 20,785,952

(4) Capital Assets, continued

	Balance at December 31, 2012	Additions	Transfers/ Retirements	Balance at December 31, 2013
Regulated capital assets				
Cables and transmission lines	$ 26,264,758	$ 432,241	$ -	$ 26,696,999
Transmission equipment	9,261,018	76,654	-	9,337,672
Buildings	8,839,503	34,887	(17,220)	8,857,170
Central office equipment	4,027,010	-	-	4,027,010
General support equipment	2,169,331	39,779	-	2,209,110
Customer premises wiring and equipment	1,209,800	62,359	-	1,272,159
Vehicles	616,144	-	-	616,144
Furniture and fixtures	28,517	5,496	-	34,013
Regulated capital assets, at cost	52,416,081	651,416	(17,220)	53,050,277
Accumulated depreciation	(38,118,960)	(1,810,003)	223	(39,928,740)
Regulated capital assets, at net book value	14,297,121	(1,158,587)	(16,997)	13,121,537
Non-regulated capital assets				
Cable television	3,048,243	77,106	(93,858)	3,031,491
Cellular	5,150,100	26,162	-	5,176,262
Palaunet	909,905	153,396	-	1,063,301
Non-regulated capital assets, at cost	9,108,248	256,664	(93,858)	9,271,054
Accumulated depreciation	(4,882,089)	(561,822)	77,405	(5,366,506)
Non-regulated capital assets, at net book value	4,226,159	(305,158)	(16,453)	3,904,548
Construction in progress	554,782	923,520	(912,723)	565,579
Total	$ 19,078,062	$ (540,225)	$ (946,173)	$ 17,591,664

Depreciation expense for the years ended December 31, 2014 and 2013 was $2,128,506 and $2,371,825, respectively, and is reported in the Statements of Revenues, Expenses and Changes in Net Position,

(5) Related Party Transactions

In the ordinary course of business, PNCC provides local and long distance telephone services, cellular telecommunications services and equipment, digital cable television services, and internet services, to the National government of the Republic of Palau and its component units. These services are provided at the same service rates and delinquent fees charged to all third-party customers. As of December 31, 2014 and 2013, amounts due from the Republic of Palau and its component units totaled $340,650 and $412,226, respectively.

(6) Long-term debt

Long-term debt as of December 31, 2014 and 2013 are summarized below:

	2014	2013
Mortgage note payable to Rural Utilities Services (RUS) at 4.59% per annum payable in monthly installments of $192,181 and due October 2029. The note is collateralized by substantially all PNCC's assets and a pledge of its revenues.	$ 24,257,785	$ 25,438,349
Note payable to Chunghwa Telecom Company in monthly installments of $34,087, non-interest bearing (net of unamortized discount of $66,041 and $123,972 at December 31, 2014 and 2013, respectively), due in July 2017, secured by earth station and ground common equipment.	990,656	1,341,769
Note payable to National Information Solutions Cooperative (NISC), non-interest bearing, payable in monthly installment of $10,482 from January 2013 through March 2013, and thereafter $13,325 monthly, due October 2017 (net of of unamortized discount of $28,981 and $49,729 at December 31, 2014 and 2013, respectively), uncollateralized.	426,296	563,202
	25,674,737	27,343,320
Less current portion	1,674,848	1,653,076
Long-term debt, net of current portion	$ 23,999,889	$ 25,690,244

RUS Mortgage Note

The original RUS note of $39,143,000 approved in 1992 was unconditionally guaranteed by ROP and stipulates that ROP will make debt service payments to RUS in the event of default. On April 8, 2009, RUS approved the request of PNCC to rescind the remaining balance of $395,047 of the mortgage note which had not been advanced. The RUS Mortgage and Security Agreement sets out certain financial ratios that must be met before a dividend can be declared. If these ratios are not met, dividends may only be declared with a written approval of RUS.

The management of PNCC believes it is in compliance with the RUS mortgage loan covenants at December 31, 2014 and 2013.

(6) Long-term debt, Continued

Future minimum principal and interest payments for RUS mortgage note for the years ended December 31, are as follows:

Years ending December 31,	Principal	Interest	Total
2015	$ 1,218,155	$ 1,088,017	$ 2,306,172
2016	1,275,259	1,030,913	2,306,172
2017	1,335,041	971,131	2,306,172
2018	1,397,625	908,547	2,306,172
2019	1,463,143	843,029	2,306,172
2020 to 2024	8,411,165	3,119,696	11,530,861
2025 to 2029	9,157,397	971,561	10,128,958
	$ 24,257,785	$ 8,932,894	$ 33,190,679

Extended Service Level of Agreement (ESLA) with Chunghwa Telecom Co. Ltd.

In December 2009, PNCC recorded and capitalized the costs of the build-up of the earth station and related equipment and improvements for PNCC's mobile and satellite network services, in exchange for a non-interest bearing note with Chunghwa Telecom Co. Ltd (CHT), a contractor from Taiwan, Republic of China, totaling $3,067,830, payable monthly in ninety (90) installments of $34,087 including interest, starting in January 2010 through July 2017. The liability recorded in the financial statements reflects future payments discounted at an imputed interest rate of 4.90%, which was the assumed long-term borrowing rate in December 2009.

At December 31, 2014, the future note payments to CHT are as follows:

Years ending December 31,	Present Value of Note	Discount Amortization	Total Note Payments
2015	$ 368,709	$ 40,335	$ 409,044
2016	387,187	21,857	409,044
2017	234,760	3,849	238,609
	$ 990,656	$ 66,041	$ 1,056,697

Pursuant to the repayment terms stated in the ESLA, in addition to non-interest bearing note disclosed in the preceding paragraph, PNCC is required to pay a monthly bandwidth fee of $14,000, net of a $1,000 courtesy discount, throughout the term of the note agreement maturing July 2017.

(6) Long-term debt, Continued

Extended Service Level of Agreement (ESLA) with Chunghwa Telecom Co. Ltd., continued

Future commitments of PNCC related to the satellite network bandwidth fees with CHT are further discussed in Note 7. For the years ended December 31, 2014 and 2013, bandwidth fees paid to CHT under this ESLA agreement totaled $168,000 in each year and are included as a component of plant specific operations expense reported in the Statements of Revenues, Expenses and Changes in Net Position.

New billing and customer care information technology system

In August 2012, PNCC entered into a note agreement with the National Information Solutions Cooperative (NISC) for the acquisition of a new billing and customer care information technology system, and for the improvement of the communication system between the PNCC sales sites and its main office. In 2012, the capitalized costs of the new information system approximates $1,180,000 with an outstanding note payable balance with NISC amounting to $764,298 as of December 31, 2012. The note was non-interest bearing, payable in fifty-eight (58) monthly installments of $10,482 from January 2013 through March 2013, and thereafter at $13,325 monthly from April 2013 through October 2017. The liability recorded in the financial statements reflects future payments discounted at an imputed interest rate of 4.59%, which was the assumed long-term borrowing rate of PNCC from the Federal Government at December 31, 2013. At December 31, 2014, the future note payments to NISC are as follows:

Years ending December 31,	Present Value of Note	Discount Amortization	Total Note Payments
2015	$ 143,323	$ 16,577	$ 159,900
2016	150,042	9,858	159,900
2017	132,931	319	133,250
	$ 426,296	$ 26,754	$ 453,050

The operational commitments of PNCC related to the NISC's technical support performance during the terms of the notes totaled $103,845, payable monthly at $540 commencing from January 2013 to October 2017, plus a $14,289 annual payment for five years from 2013 through 2017. For the years ended December 31, 2014 and 2013, amounts paid to NISC for technical support under the agreement totaled $29,678 and $20,769, respectively, and are reported as a component of plant specific operations expense reported in the Statements of Revenues, Expenses and Changes in Net Position. As of December 31, 2014, the remaining commitments chargeable to operations are included in Note 7.

(6) Long-term debt, Continued

At December 31, 2014 and 2013, the changes in the long-term liabilities are as follows:

	Balance January 1, 2014	Additions	Reductions	Balance December 31, 2014	Current	Noncurrent
Rural Utilities Services	$ 25,438,349	$ -	$ 1,162,815	$ 24,275,534	$ 1,217,323	$ 23,058,211
Chunghwa Telecom Company, Ltd., net of discount	1,341,769	-	351,113	990,656	268,709	721,947
National Information Solutions Cooperative, net of discount	563,202	-	139,147	424,055	143,423	280,632
	$ 27,343,320	$ -	$ 1,653,075	$ 25,690,245	$ 1,629,455	$ 24,060,790

	Balance January 1, 2013	Additions	Reductions	Balance December 31, 2013	Current	Noncurrent
Rural Utilities Services	$ 26,391,326	$ -	$ 952,977	25,438,349	$ 1,162,816	$ 24,275,533
Chunghwa Telecom Company, Ltd., net of discount	1,648,882	-	307,113	1,341,769	351,113	990,656
National Information Solutions Cooperative, net of discount	663,423	-	100,221	563,202	139,147	424,055
	$ 28,703,631	$ -	$ 1,360,311	$ 27,343,320	$ 1,653,076	$ 25,690,244

Interest expense paid in 2014 and 2013 amounted to $1,433,267 and $1,420,094, respectively.

(7) Contract Payable

PNCC entered into a Third Generation (3G) Mobile Network Agreement on April 2, 2014. Under this agreement, PNCC agreed to purchase a turnkey complete 3G network for Palau for a total of $4,360,000. The contract calls for a down payments of $218,000 within two weeks of signing, another $218,000 on or before September 30, 2014 and $697,600 on or before January 31, 2015. The remaining balance is to be paid at $83,000 per month from February 2015 to July 2015 and then at $100,000 per month until the balance is paid off. Interest will be applied to the unpaid balance at the rate of 2.4% per annum for the first 12 months from February 2015 to January 2016 and then at the rate of 4.8% per annum until the balance is paid off.

(7) Contract Payable, Continued

As of December 31, 2014 PNCC had paid $436,000 to the vendor under this contract. The system was completed and activated on January 10, 2015. Since the system was substantially complete as of December 31, 2014 the entire system cost has been capitalized as construction in progress and the remaining unpaid balance of $3,924,000 has been recognized as a liability in the accompanying Statements of Net Position.

Future payments under this contract are as follows:

Years ending December 31,	Principal	Interest	Total
2015	$ 1,695,600	$ 59,515	$ 1,755,115
2016	1,200,000	71,506	1,271,506
2017	1,028,400	19,136	1,047,536
	$ 3,924,000	$ 150,157	$ 4,074,157

(8) Commitments and Contingencies

Commitments

PNCC has entered into long-term commitments for non-cancelable channel distribution agreements, transition and support services for providers of telecommunication network services, satellite bandwidth capacity services, and innovation in information technology. The approximate future minimum annual payments under these agreements are as follows:

Years ending December 31:	
2015	$ 915,000
2016	1,200,000
2017	1,900,000
	$ 4,015,000

At December 31, 2014, PNCC has outstanding purchase order commitments for remote support and software maintenance and upgrade of softswitch from an off-island vendor, and some local procurement of supplies which have not been received as of December 31, 2014. The accrual basis of accounting provides that expenses include only amounts associated with goods and services received and liabilities include only the unpaid amounts associated with such expenses. Accordingly, $697,600 of outstanding purchase commitments are not reported in the financial statements for the year ended December 31, 2014.

(8) Commitments and Contingencies

Contingencies

Risk Management

PNCC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters, employee health, dental and accident benefits. PNCC has elected to purchase commercial insurance coverage for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the past three years. PNCC is self-insured for buried cables and customer premises wirings. Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported within the last three years.

Claims and Litigation

In the normal course of business, PNCC is involved in various claims and litigation or has received several claims that are pending review or are expected to go to litigation. Management believes that any liability it may incur would not have a material adverse effect on its financial condition or its results of operations.

Health (Sick) Leave

PNCC's policy is to record expenditures for health (sick) leave when the leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated sick leave at December 31, 2014 and 2013 is $1,004,497 and $1,037,753, respectively.

(9) Fair Value of Financial Instruments

PNCC's financial instruments are cash and cash equivalents, accounts receivable, other assets, investments, accounts payable, payable to carriers, accrued expenses, unearned revenue, customer deposits, notes payable, contract payable and long-term debt. The recorded values of these instruments for cash and cash equivalents, accounts receivable, other assets, investments and accounts payable, payable to carriers, accrued expenses, unearned revenues, and the current portions of contract payable and long-term debt approximate their fair values based on their short-term nature. The recorded value of customer deposits approximates its fair value as it is the amount payable on demand at the reporting date. The recorded value of RUS note payable approximates its fair value, as interest approximates market rates.

(9) Fair Value of Financial Instruments, Continued

The fair value of long-term debt with CHT and NISC and the related unamortized discount is estimated by discounting the future cash flow using the PNCC'S current borrowing rate for similar types and maturities of debt.

(10) Reclassifications

Certain amounts presented in 2013 have been reclassified to conform to the 2014 financial statement presentation. These reclassifications did not affect the change in net position or the total net position.

(11) Subsequent Events

PNCC has evaluated subsequent events from September 30, 2014 through May 15, 2015, the date the financial statements were available to be issued. PNCC did not note any subsequent events requiring disclosure or adjustment to the accompanying financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

SUPLEMENTARY SCHEDULES

Year Ended December 31, 2014

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Schedule of

Budget vs Actual (GAAP Basis)

For The Year Ended December 31, 2014

	Budget				Variance Favorable
	Original	Revisions	Final	Actual	(Unfavorable)
Operating revenues:					
Cellular	$ 4,259,472	$ -	$ 4,259,472	$ 4,289,077	$ 29,605
Palaunet	2,625,034	-	2,625,034	2,936,599	311,565
Local	1,485,661	-	1,485,661	1,487,049	1,388
Digital television	1,432,786	-	1,432,786	1,339,854	(92,932)
Long distance	1,430,753	-	1,430,753	1,451,216	20,463
Miscellaneous	597,613	-	597,613	89,659	(507,954)
Provision for doubtful accounts	-	-	-	(249,587)	(249,587)
Total operating revenues	11,831,319	-	11,831,319	11,343,867	(487,452)
Operating expenses:					
Plant specific operations	3,374,475	-	3,374,475	3,912,022	(537,547)
Depreciation	2,458,849	-	2,458,849	2,128,506	330,343
Customer service operations	1,576,353	-	1,576,353	1,078,695	497,658
Corporate operations	750,831	-	750,831	1,245,085	(494,254)
Plant non-specific operations	393,549	-	393,549	279,170	114,379
Total operating expenses	8,554,057	-	8,554,057	8,643,478	(89,421)
Operating income (loss)	3,277,262	-	3,277,262	2,700,389	(576,873)
Nonoperating income (expenses):					
Interest expense	(1,337,183)	-	(1,337,183)	(1,433,267)	(96,084)
Interest and other income	62,550	-	62,550	130,208	67,658
Other expenses, net	(45,334)	-	(45,334)	-	45,334
Total nonoperating expenses, net	(1,319,967)	-	(1,319,967)	(1,303,059)	16,908
Change in net position	$ 1,957,295	$ -	$ 1,957,295	$ 1,397,330	$ (559,965)

See Accompanying Independent Auditors' Report.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Schedule of Functional Expenses
For The Year Ended December 31, 2014
(With Comparative Totals for 2013)

	Plant Specific					Plant	Total	
	Depreciation	Operation	Corporate	Customer Relations	Total	non-specific operations	Operating Expenses 2014	2013
Outside services	$ -	$ 2,262,727	$ 114,683	$ 849,959	$ 3,227,369	$ 219	$ 3,227,588	$ 2,910,604
Depreciation	2,128,506	-	-	-	2,128,506	-	2,128,506	2,371,825
Salaries and wages	-	508,087	497,665	261,945	1,267,697	170,120	1,437,817	1,505,048
Utilities	-	752,123	-	-	752,123	-	752,123	866,858
Payroll burden	-	212,124	182,845	124,911	519,880	85,626	605,506	618,764
Others	-	34,459	44,933	2,359	81,751	11,819	93,570	139,846
Insurance	-	-	91,523	-	91,523	-	91,523	51,567
Training	-	1,167	83,588	-	84,755	975	85,730	212,549
Clearance	-	83,850	-	-	83,850	301	84,151	114,530
Materials and supplies	-	34,677	14,570	4,866	54,113	2,903	57,016	176,116
Fuel	-	20,100	6,993	1,045	28,138	7,207	35,345	59,166
Postage	-	-	21,866	-	21,866	-	21,866	25,597
Legal fees	-	-	12,000	-	12,000	-	12,000	15,925
Board fees	-	-	8,029	-	8,029	-	8,029	13,303
Inventory obsolescense	-	2,708	-	-	2,708	-	2,708	-
	$ 2,128,506	$ 3,912,022	$ 1,078,695	$ 1,245,085	$ 8,364,308	$ 279,170	$ 8,643,478	$ 9,081,698

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Schedule of Functional Expenses by Division
For The Year Ended December 31, 2014
(With Comparative Totals for 2013)

	Depreciation	Operation	Corporate	Customer Relations	Total Operating Expenses By Division 2014	2013
Telephony						
Depreciation	$ 1,546,114	$ -	$ -	$ -	$ 1,546,114	$ 1,810,003
Salaries and wages	-	317,931	497,665	261,945	1,077,541	1,056,299
Utilities	-	706,708	-	-	706,708	818,246
Outside services	-	367,604	114,683	4,256	486,543	339,669
Payroll burden	-	132,125	182,845	124,911	439,881	421,676
Insurance	-	-	91,523	-	91,523	51,567
Training	-	1,167	83,589	-	84,756	204,519
Clearance	-	57,977	-	-	57,977	64,773
Materials and supplies	-	34,129	14,470	4,866	53,465	130,739
Others	-	12,604	14,781	148	27,533	94,491
Fuel	-	20,100	5,539	1,046	26,685	49,252
Postage	-	-	21,866	-	21,866	25,407
Legal fees	-	-	12,000	-	12,000	15,925
Board fees	-	-	8,029	-	8,029	13,303
Inventory obsolesence	-	2,708	-	-	2,708	-
Allocation	-	-	(260,452)	(115,266)	(375,718)	(371,582)
	1,546,114	1,653,053	786,538	281,906	4,267,611	4,724,287
Cellular						
Depreciation	362,665	-	-	-	362,665	360,258
Outside services	-	330,833	-	-	330,833	245,308
Allocation	-	-	86,817	42,813	129,630	128,928
Utilities	-	41,939	-	-	41,939	46,712
Others	-	8,349	29,500	-	37,849	20,191
Salaries and wages	-	26,400	-	-	26,400	45,814
Payroll burden	-	11,311	-	-	11,311	20,073
Fuel	-	-	1,454	-	1,454	3,241
Materials and supplies	-	185	100	-	285	40
Clearance	-	10	-	-	10	-
	362,665	419,027	117,871	42,813	942,376	870,565
Palaunet						
Outside services	-	1,530,278	-	-	1,530,278	1,436,331
Depreciation	89,216	-	-	-	89,216	80,145
Allocation	-	-	52,090	36,226	88,316	84,125
Salaries and wages	-	28,271	-	-	28,271	50,414
Others	-	13,289	-	-	13,289	3,306
Payroll burden	-	9,913	-	-	9,913	25,496
Clearance	-	5,391	-	-	5,391	13,460
Materials and supplies	-	4,107	-	-	4,107	3,066
	89,216	1,591,249	52,090	36,226	1,768,781	1,696,343
Digital TV						
Outside services	-	34,012	-	845,703	879,715	888,788
Allocation	-	-	121,544	36,226	157,770	158,529
Salaries and wages	-	135,485	-	-	135,485	153,683
Depreciation	130,511	-	-	-	130,511	121,419
Payroll burden	-	58,775	-	-	58,775	77,519
Clearance	-	20,472	-	-	20,472	35,939
Utilities	-	3,476	-	-	3,476	1,900
Others	-	217	652	2,211	3,080	7,939
Materials and supplies	-	(3,744)	-	-	(3,744)	39,227
	130,511	248,693	122,196	884,140	1,385,540	1,485,133
	$ 2,128,506	$ 3,912,022	$ 1,078,695	$ 1,245,085	$ 8,364,308	$ 8,776,328

See Accompanying Independent Auditors' Report.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL AND ON COMPLIANCE

Year Ended December 31, 2014

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

To the Board of Directors
Palau National Communications Corporation

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise PNCC's basic financial statements and have issued our report thereon dated May 15, 2015.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as Findings 2014-01 and 2014-03 to be material weaknesses.

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A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany schedule of findings and responses as Finding 2014-02 to be a significant deficiency.

Compliance and Other Matters

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

PNCC's Response to Findings

PNCC's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. PNCC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Burger Comer Magliari

BURGER COMER MAGLIARI
Koror, Republic of Palau
May 15, 2015

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Schedule of Findings and Responses
Year Ended December 31, 2014

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? __X__ yes ___ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? __X__ yes ___ no
- Noncompliance material to financial statements? _____ yes __X__ no

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-01
Area : Allowance for Doubtful Accounts

Criteria:

Policies and procedures should be documented and maintained for calculating the allowance for uncollectible accounts receivable. The purpose of this policy and procedure is to document the process for estimating the allowance for doubtful accounts for accounts receivable. Proper internal control over financial reporting requires that an allowance for uncollectible accounts receivable be calculated and reported in a timely manner. These policies and procedures should include formal written credit approval policies and procedures to manage and reduce the risk of write off of uncollectible accounts.

Condition:

PNCC performs evaluation of its doubtful accounts on year-end basis only, and not on a periodic basis. A provision for uncollectable accounts for 2014 was calculated and determined in March 2015 totaling $249,587 which was simply added to the accumulated beginning balance. The analysis of changes of allowances for bad debts for the last six (6) years is as follows:

	As of December 31,					
	2014	2013	2012	2011	2010	2009
Balance, beginning of year	$ 4,214,265	$ 4,083,262	$ 3,503,641	$ 3,195,114	$ 3,195,114	$ 2,908,271
Current year provisions	249,587	274,923	778,427	308,527	-	310,108
Writte-off	(1,045,889)	(143,920)	(198,806)	-	-	(23,265)
Balance, end of year	$ 3,417,963	$ 4,214,265	$ 4,083,262	$ 3,503,641	$ 3,195,114	$ 3,195,114

Cause:

PNCC does not have formalized policies and procedures for estimating the amount of uncollectible accounts receivable to be recorded as an allowance for doubtful accounts.

Effect:

Uncollectable old accounts estimated at $2.8 million or 81% are ageing in the receivable trial balance and are not written-off and removed from the general ledger and subsidiary ledger. The potential exists for inappropriate or fraudulent write-offs to occur and not be detected in a timely manner. Management may make significant decisions based on inaccurate information.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-01, Continued
Area : Allowance for Doubtful Accounts

Prior Year Status:

Similar conditions of untimely review and evaluation of accounts receivable ageing trial balance was cited as finding in the 2009 through 2013 audits of PNCC.

Recommendation:

PNCC management should formalize collection procedures over control of accounts receivable. These policies and procedures should provide guidance on recording, collecting, and writing off accounts receivable and returned checks. We recommend that past-due balances be reviewed monthly. When truly uncollectible accounts are indentified, they should be written-off and removed from the books. This process, however, should not occur until all collection efforts are exhausted and the account is no longer worth pursuit.

Auditee Response and Corrective Action Plan:

PNCC agrees with this finding. The PNCC Board of Directors has adopted “Accounts Receivable Policy”. The Chief Financial Officer will work with Finance & Administration Department staff to prepare clear procedures for account write-off, procedures for account reconciliations and procedures for collections. Once procedures are implemented, CFO will ensure they are adhered to at all times.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-02
Area : Review of Customer Deposits

Criteria:

PNCC's customer deposits consist of subscriber deposits, installation fees and amounts received for related services and subscriptions to be provided in future periods. PNCC's policy requirement of customer deposit amount varies depending on the type of service or subscription applied for. Deposits are eligible for refunding after twelve (12) consecutive months of prompt payment history. If a deposit is held on an account at the time services are terminated, the deposit will be applied to the unpaid balance and refund check is issued for the remainder. Refunds are not automatic and the customer must request a refund.

Condition:

The year-end deposit listings totaled $698,345 representing numerous inactive customer deposits over 10 years old, and whose deposits can be applied to the customer's unpaid balance. As noted in Finding No. 2014-01, accounts receivable that are potential for write-off approximate $2.8 million and the corresponding customer deposit was not applied to reduce the write-off.

Cause:

Because there is no formalized accounts receivable collection policy, internal control policies have not been implemented to determine when and how customer deposits should be applied to past-due or terminated account balances. Additionally, some customers no longer pursue request for a deposit refund because of the time and effort involved.

Effect:

The propriety of some customer deposits may not be a liability and might be a recovery of previously provided allowance for uncollectibility of accounts receivable outstanding for over 10 years.

Prior Year Status:

The lack of internal control and a formalized accounts receivable collection policy over customer deposits was cited as a finding in the audit of PNCC for the year 2013.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-02, Continued
Area : Review of Customer Deposits

Recommendation:

Management should review and revise its procedures over maintaining, accounting for and application of customer deposits in relation to accounts receivables and the allowance for doubtful accounts. Management review of this area can result in a reduction in the number and amount of delinquent and potential uncollectible accounts receivable. An in-house study should be conducted to determine to what extent, if any, deposits should be applied to the receivable allowance account.

Auditee Response and Corrective Action Plan:

PNCC agrees with this finding and after thorough reconciliation, customer deposits will be applied to outstanding customer account balances in accordance with PNCC's Accounts Receivable Write-off policy.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-03
Area : Unearned revenues from prepaid long distance sales and prepaid airtime

Criteria:

Written policies and procedures should exist to reconcile actual long distance minutes billed by international carrier amounts to the general ledger control accounts on a monthly and year-end basis. Recognition of revenues from international prepaid calling cards/airtime should only be recognized when actual minutes are used.

Condition:

Periodic reconciliations and evaluation are not performed for long distance revenue or for prepaid international calling card and prepaid airtime based on actual minutes used. When customers do not use all of the time value of international prepaid calling card, the unused portion of the dollar value of the prepaid calling card (commonly known as breakage), maybe estimated based on historical trends. At December 31, 2014, deferred revenues from unused long distance prepaid card and wireless airtime were not calculated and recognized.

Cause:

There is a deficiency in the network system for determining unused minutes representing unearned revenue from prepaid long-distance card and prepaid airtime wireless. There also a lack of internal control policies and procedures to ensure that long distance revenue are reconciled with outbound minutes billed by international carriers on a periodic basis.

Effect:

Prepaid long distance card sales and prepaid wireless card sales may be overstated by deferred revenues from unused minutes.

Prior Year Status:

The lack of reconciliation of actual minutes billed by international carriers and actual minutes used for prepaid airtime to revenue control totals was reported as finding in the audit of PNCC for the years 2007 through 2013.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2014-03, Continued
Area : Unearned revenues from prepaid long distance sales and prepaid airtime

Recommendation:

PNCC should document and adhere to existing policies and procedures over the reconciliation of long distance minutes and international prepaid calling card/airtime. Minutes billed by internationals carriers should be reconciled to long distance revenue control on a periodic basis. Recognition of revenues from international prepaid calling cards/airtime should only be recognized when actual minutes are used. Unearned revenues should be recognized from unused prepared debusch and airtime.

Auditee Response and Corrective Action Plan:

PNCC agrees with this finding. The Chief Financial Officer will ensure regular monthly reconciliation of long distance revenues will be carried out. Efforts will continue to procure and implement a system capable of generating data needed to support accounting of deferred/unearned airtime minutes.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Independent Auditors' Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Telecommunications Borrowers

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Year Ended December 31, 2014

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR TELECOMMUNICATIONS BORROWERS

Board of Directors
Palau National Communications Corporation

We have audited 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, the financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statement of net position as of December 31, 2014, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 15, 2015. In accordance with Government Auditing Standards, we have also issued our report dated May 15, 2015, on our consideration of PNCC's internal control over financial reporting on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred above and our separate letter regarding recommendations concerning certain matters related to internal control, also dated May 15, 2015 related to our audit, have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that PNCC failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, Policy on Audits of Rural Utilities Service Borrowers, Section 1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding PNCC's noncompliance with above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, as except of the comments noted below, we noted no matters regarding PNCC's accounting and records to indicate that PNCC did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

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- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies.
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system in the contract covers all or substantially all of the telecommunication system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements addressed in 7 CFR Part 1733.33(g); and
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. At December 31, 2014, PNCC had no investments in subsidiary and affiliated companies that needed to be accounted for on either the cost or equity basis in accordance with the requirement of 7 CFR Part 1733.33(i).

* * * * * * * * *

This report is intended solely for the information and use of the management of PNCC, the Board of Directors and the Rural Utilities Service and supplemental lenders and is not intended to be and should not be used be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Burger Comer Magliari

BURGER COMER MAGLIARI
Koror, Republic of Palau
May 15, 2015

STATUS OF PRIOR YEAR FINDINGS

The status of the unresolved prior year findings are disclosed within the Schedule of Findings and Responses section of this report on pages 48 through 53.