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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT

Years Ended December 31, 2021 and 2020

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

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December 31, 2021 and 2020

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Palau National Communications Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statements of net position as of December 31, 2021 and 2020, 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, which collectively comprise the PNCC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Palau National Communications Corporation as of December 31, 2021 and 2020, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 13 to the financial statements, the Corporation's operations have been affected by the recent and on-going outbreak of the coronavirus disease. As a result of the spread of the COVID-19 coronavirus, governments worldwide implemented actions to restrict travel and economic activities. The ultimate disruption which may be caused by the outbreak is uncertain, therefore, the actual impact on the Corporation's business, results of operations, and financial position for the year ended 2022 and beyond is currently not determinable. Our conclusion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (MD&A) on pages 4 through 10, the Schedule of Budgetary Comparison information on page 54, the Schedule of Proportional Share of the Net Pension Liability on page 57, and the Schedule of Pension Contributions on page 58, 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. This supplementary information is the responsibility of PNCC's management. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Financial Information

Our audit was conducted for the purpose of forming an opinion on PNCC's basic financial statements that collectively comprise the Palau National Communications Corporation's basic financial statements. The Schedules of Functional Expenses on pages 55 and 56 are presented for purposes of additional analysis and are not required part of the financial statements. The Schedule of Investments is the responsibility of the PNCC's management and was derived from and relates to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting 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 basic financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated February 3, 2023 on our consideration of the PNCC's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the PNCC's internal control over financial reporting and compliance.

Burger Comer Magliari

Koror, Republic of Palau
February 3, 2023

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

Management's Discussion and Analysis
December 31, 2021

Introduction

This section presents the financial analysis of Palau National Communications Corporation's (PNCC) performance for the fiscal year ended December 31, 2021. It also includes a comparison with the prior years ended December 31st, 2020, and 2019.

Business Overview

Palau National Communications Corporation (PNCC) provides nationwide telecommunication services in Palau through Mobile and Fixed Line networks. The services offered by PNCC include:

- Mobile Data and Voice services via 4G/3G/2G cellular systems with near nationwide coverage
- Fixed line Broadband Internet via ADSL and VDSL technologies over copper lines as well as through P2P fibre for larger Corporate & Government customers
- Digital TV service over copper coaxial cable
- Landline Phone Service over copper cable

Subscribers

Mobile subscriptions showed a 4% increase in 2021, with a 7% increase in Postpaid and 3% increase in Prepaid services, respectively. However, despite the increase in subscribers, Mobile ARPU (Average Revenue per User) declined from $19.57 in 2020 to $17.49 in 2021, a decrease of $2.09 or 11% YoY.

Since 2017, mobile subscribers had steadily increased, but in 2020 as a result of the COVID-19 pandemic, the number of subscriptions declined. In 2021, the number of subscriptions rebounded as economic activity in the country slowly increased and more customers required mobile services once again.

Overall, the Fixed Line business saw a net decrease in the number of subscriptions, with a 2% decrease in Business/Government sectors overshadowing a 1% increase in Residential subscriptions.

Internet subscriptions increased by 4% YoY driven HomeNet services. This gradual growth trend which has persisted since 2017 is expected to continue through 2022 and sharply accelerate in 2023 with the commencement of FTTP (Fibre to the Premises) rollout funded by the USDA's RUS ReConnect III program.

Digital TV showed a decline of 10%, with a 12% decrease in Residential subscriptions. This trend of decline is in line with global trends for linear TV service driven by the pressure from OTT VOD services such as Netflix and Hulu. This trend is expected to slow in 2022 and stabilize in 2023 as the FTTP rollout enables IPTV which will deliver a significantly improved quality of service.

Subscribers	2017	2018	2019	2020	2021	YoY	Variance
GSM Mobile	26,546	26,524	32,868	26,359	27,335	976	3.7%
Postpaid	*2,916*	*3,123*	*3,914*	*4,742*	*5,079*	*337*	7.1%
Prepaid	*23,630*	*23,401*	*28,954*	*21,617*	*22,256*	*639*	3.0%
Fixed Line (Telephone)	7,088	7,166	6,801	6,179	6,165	-14	-0.2%
Business/Government	*3,071*	*3,047*	*2,897*	*2,214*	*2,161*	*-53*	-2.4%
Residential	*4,017*	*4,119*	*3,904*	*3,965*	*4,004*	*39*	1.0%
Internet	3,001	3,619	3,901	4,211	4,382	171	4.1%
PalauNet	*1,008*	*1,302*	*1,086*	*944*	*844*	*-100*	-10.6%
DSL	*328*	*309*	*364*	*390*	*427*	*37*	9.5%
Domestic Leased Line/VLAN	*67*	*62*	*31*	*26*	*23*	*-3*	-11.5%
Wi-Fi Hotspots	*195*	*214*	*237*	*242*	*244*	*2*	0.8%
HomeNet	*1,403*	*1,732*	*2,183*	*2,604*	*2822*	*218*	8.4%
Premium WiFi	-	-	-	*5*	*22*	*17*	340.0%
Digital TV	4,138	3,786	3,370	2,743	2,474	-269	-9.8%
Single Dwelling	*3,260*	*2,939*	*2,623*	*2,377*	*2,103*	*-274*	-11.5%
Multi Units	*878*	*847*	*747*	*366*	*371*	*5*	1.4%

Table 1. Subscribers 5 Year Trend

Financial Highlights

At the end of 2021, total current assets increased by $0.25m or 9% Year-on-Year. At the same time total assets decreased by $1.4m Year-on-Year, mainly driven by depreciation leading to a $1.66m or 8% reduction in plant and equipment, while negative performance of investments contributed $0.36m to the deficit.

The increase in total liability reflects the $1.3m under unearned revenues. However, PNCC managed to reduce other liabilities, including a decrease of 64% in accounts payable, 30% in accrued expenses, 21% in customer deposits, and 12% in notes payable.

In 2020, the negative net income of $1.5m increased the negative net position to $1.7m. In 2021, the negative net income of $2.8m further increased the negative net position to $4.5m at the end of the year.

In compliance with GASB 67&68, $11.8 million in 2020 and $13.6 million in 2021 Pension Liability resulted in a cumulative deficit of -$4.5m at the end of 2021 as the net position for the year.

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

Management's Discussion and Analysis
December 31, 2021

Statements of Net Position

Years ended December 31, 2021, 2020, and 2019

ASSETS	**2021**	**2020**	**2019**
Current Assets			
Cash	$ 345,678	$ 465,082	$ 296,738
Time certificate of deposit			
Restricted cash and cash equivalents	250,171	250,146	250,113
Receivables, net	1,718,117	1,336,291	1,988,686
Inventories	626,488	523,710	519,658
Deposit	-	-	-
Prepaid expenses	193,874	302,368	217,705
Total current assets	**$ 3,134,328**	**$ 2,877,597**	**$ 3,272,900**
Investments	2,353,857	2,712,124	2,222,750
Other noncurrent assets	54,300	54,300	60,773
Plant and equipment, net	19,544,319	21,205,813	22,267,832
Total Assets	**$25,086,804**	**$26,849,834**	**$27,824,255**
Deferred outflows of resources:			
Deferred outflows from pension	4,686,869	4,284,465	2,000,476
Total Assets	**$29,773,673**	**$31,134,299**	**$29,824,731**
LIABILITIES AND NET POSITION			
Current liabilities			
Current Portion of Contract Payable			
Current portion of long-term debt	$ 4,013,777	$ 2,357,943	$ 1,531,736
Accounts payable	575,419	1,610,170	1,028,617
Payable to carriers, net	38,111	13,566	-
Accrued expenses	281,525	401,735	465,262
Unearned revenues	1,347,717	-	900
Customer deposits	485,171	570,197	621,054
Total current liabilities	**$ 6,741,720**	**$ 4,953,611**	**$ 3,647,569**
Contract Payable, net of current portion	-	-	-
Note payable, net of current portion	12,557,081	14,235,792	15,839,333
Net Pension Liability	13,660,411	11,837,827	8,712,379
Total liabilities	**$32,959,212**	**$31,027,230**	**$28,199,281**
Defered inflows of resources			
Deferred inflows from Pension	$ 1,331,405	$ 1,775,894	$ 1,774,821
Commitment and contigencies			
Net position:			
Invested capital assets, net of related debt	2,973,461	4,612,078	4,896,763
Restricted - Debt service reserve	250,171	250,146	250,113
Unrestricted	(7,740,576)	(6,531,049)	(5,296,247)
Total net position	**$ (4,516,944)**	**$ (1,668,825)**	**$ (149,371)**
Total Liabilities and Net Position	**$29,773,673**	**$31,134,299**	**$29,824,731**

Statement of Revenues, Expenses and Changes in Net Position

Years ended December 31, 2021, 2020, and 2019

The decrease in total operating revenues in 2021 was primarily driven by declines in Cellular revenue of $0.45m or -7%, Home Broadband (PalauNet) of $0.2m or -6% and Digital Television revenue of $0.12m or -10%. A slight increase in Local revenue of $0.09m or 5% was driven by demand for fixed lines to residential customers to facilitate broadband internet service. Total revenue for 2021 decreased by $0.62m or -5%.

In order to mitigate the negative YoY revenue trends significant focus was placed on efficiency and cost control in the business resulting in total operating expenses remaining largely flat YoY, increasing by just $0.05m or 0.03% YoY despite sharp increases in the prices of electricity and fuel, two of PNCC's highest monthly expenses, with the Energy basket of Palau's CPI index increasing by 8.8% YoY. Cost reduction initiatives effectively delivered reductions in Plant Non-Specific Operations, Corporate Operations, and Customer Service Operations to offset the higher costs of energy.

Despite the cost reductions, the operating loss from operations still increased by $0.67m or 52% from -$1.3m in 2020 to $1.9m in 2021.

Change in Net Position US$m	2019		2020		2021		Variance		Var. %
Operating revenues	$	13.73	$	12.27	$	11.65	$	(0.62)	-5%
Operating expenses	$	(14.10)	$	(13.54)	$	(13.59)	$	(0.05)	-0.3%
Operating income	$	(0.36)	$	(1.27)	$	(1.94)	$	(0.67)	-52%
Non-operating income (expenses)	$	(0.82)	$	(0.24)	$	(0.91)	$	(0.66)	-270%
Change in net position	**$**	**(1.18)**	**$**	**(1.52)**	**$**	**(2.85)**	**$**	**(1.33)**	**87%**

Table 2. Change in Net Position US$m

Revenue Source US$m	2019		2020		2021		Variance		Var. %
Cellular	$	7.37	$	6.19	$	5.74	$	(0.45)	-7%
Long Distance	$	0.19	$	(0.02)	$	(0.09)	$	(0.07)	-421%
Palaunet	$	3.09	$	3.13	$	2.93	$	(0.20)	-6%
Local	$	1.51	$	1.70	$	1.79	$	0.09	5%
Digital Television	$	1.45	$	1.23	$	1.11	$	(0.12)	-10%
Miscellaneous	$	0.25	$	0.14	$	0.16	$	0.02	15%
Provision for doubtful accts	$	(0.12)	$	(0.10)	$	-	$	0.10	-100%
Total	**$**	**13.73**	**$**	**12.27**	**$**	**11.65**	**$**	**(0.62)**	**-5%**

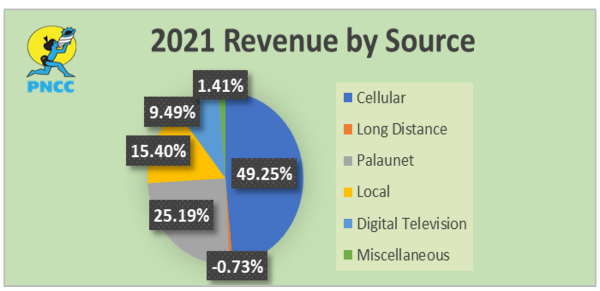
Table 3. Revenue by Source US$m

The economic problems caused by COVID-19 continue to pose a negative impact on PNCC's revenue, resulting in a decrease of 5% Year-on-Year. The closure of the country's borders, foreign laborers returning home, and the closure of businesses, especially in the tourism sector, were the key factors impacting Year-on-Year revenue.

While 2021 Cellular Revenue continued the trend of decline from 2019 to 2020 it was at a much reduced rate – in 2020 revenue declined 16% YoY while in 2021 revenue declined 7% YoY. It is expected that with the gradual reduction in Covid-19 cases and restrictions being seen globally that this trend of decline is arrested in 2022 and that the business returns to growth in 2023.

The reduction in tourism due to the pandemic further compounded the ongoing decline in Long Distance Revenue which in previous years has been primarily impacted by the proliferation of OTT Voice and Messaging applications such as WhatsApp & Facebook Messenger. This lead to Long Distance Revenue of -0.09m which was a reduction of -0.07m YoY or -421%. Long Distance Revenue has been reported net of direct costs payable to international carrier partners, leading to negative revenue values for 2020 and 2021.

The reduction in DTV is also caused by the change in customers' preferences in favor of OTT VOD and other non-linear video services and platforms such as Netflix, Hulu and YouTube as well as web-based illegal streaming services providing pirated linear and VOD content. Despite the economic challenges, the Local revenue showed an increase of 5% as new homeowners continue to subscribe for services.



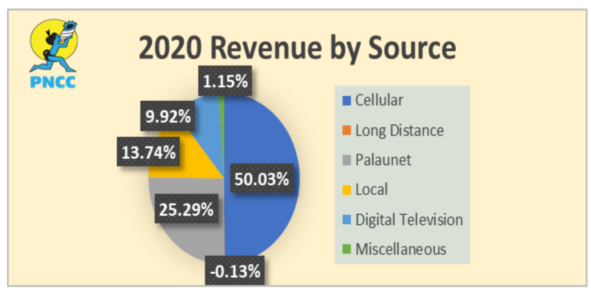


Chart 1. Revenue by Source 2020 and 2021 Comparison

The summarized chart shows the major revenue sources where the cellular operations contributed 49% of the total revenue in 2021. While this was a slight decrease Year-on-Year of 1% Cellular remains the dominant revenue source in the business and will be the focus of revenue recovery in 2022 and the source of revenue growth in 2023.

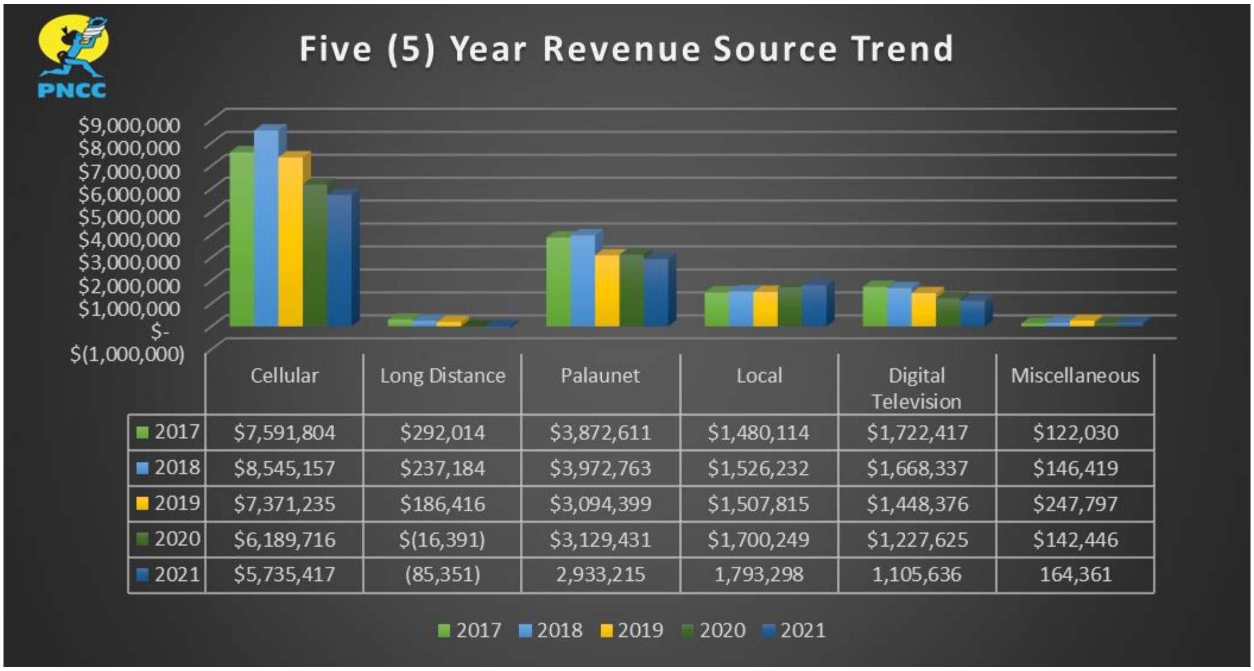


Chart 2. Revenue by Source 5 Year Trend

The five year revenue trend shows the trend of reduction in Cellular Revenue more clearly with sharp declines in 2018 (13%) and 2019 (16%) and a slower rate of decline from 2020 to 2021 (7%). The decreases in 2018 and 2019 are attributed to extraordinary events which are not expected to repeat. From 2018 to 2019 the decline was largely caused by changing market dynamics due to the cessation of online gambling businesses in Palau. While from 2019 to 2020 the decline is a result of the start of the Covid-19 pandemic with the associated lock-downs, border closures and reduction in tourism which had wide reaching negative impacts on the local economy.

PNCC Strategic Planning Process

PNCC updated its Strategic Plan in 2018, which covers a five-year period from 2019 to 2024. The objectives of this plan are to:

- Accelerate sustainable growth and optimize self-financing capabilities in order to create world-class telecommunications environment for the nation of Palau.
- Create an organization where each individual works inspired, motivated, and aligned as one force for best-serving customers.

Specific opportunities for service improvement and revenue growth identified within the plan focus on the expansion of mobile data services, growth of residential broadband services, the expansion of the product portfolio to include new innovative products and a greater focus on revenue service for tourists including roaming and tourist specific product offerings.

Since the plan was set in 2018 Cellular subscribers have increased by 0.8k or 3% while residential broadband customers have increased by 1.2k subscribers or 52%.

Expansion of the product portfolio as well as additional products targeting tourists have been launched in the period including:

- Launch of Prepaid Bundle Plans and Postpaid Data Plans
- Launch of bill pay (postpaid) residential broadband service as HomeNet
- Airport Kiosk launched to serve inbound tourists with targeted offers including:
    - A partnership with Softbank for Mobile Data Hotspot rental
    - Tourist SIM offer
- Expansion of International Roaming Partners

New products which will help meet the evolving needs of PNCC's customer base as well as provide incremental revenue opportunities are anticipated in 2023 as the Covid-19 pandemic period draws to a close and economic activity in the country increases.

CONTACTING PNCC'S FINANCIAL MANAGEMENT

In conclusion, the Management's Discussion and Analysis for the year ended December 31, 2021, set forth in the report on the audit of PNCC, provides a general overview of PNCC's finances and demonstrates PNCC's transparency and accountability. For any additional information or questions, interested parties can contact the Chief Financial Officer at the Palau National Communications Corporation, P.O. Box 99, Koror, Republic of Palau 96940, or email rramarui@pnccpalau.com or call 587-9000.

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

FINANCIAL SECTION

Years Ended December 31, 2021 and 2020

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

Statements of Net Position
December 31, 2021 and 2020

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	2021	2020
Current assets:		
Cash	$ 345,678	$ 465,082
Receivables:		
Trade	1,774,876	1,838,816
Related party	594,432	391,212
Carriers, net	208,313	348,882
Other receivable	503,188	(402)
Allowance for doubtful accounts	(1,362,692)	(1,242,217)
Total receivables, net	1,718,117	1,336,291
Inventories, net	626,488	523,710
Prepaid expenses	193,874	302,368
Total current assets	2,884,157	2,627,451
Investments	2,353,857	2,712,124
Restricted cash and cash equivalents	250,171	250,146
Other noncurrent assets	54,300	54,300
Capital assets, net	19,544,319	21,205,813
Total assets	25,086,804	26,849,834
Deferred outflows of resources:		
Deferred outflows from pension	4,686,869	4,284,465
Total assets and deferred outflows of resources	$ 29,773,673	$ 31,134,299

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

	2021	2020
Current liabilities:		
Current portion of long-term debt	$ 4,013,777	$ 2,357,943
Accounts payable	575,419	1,610,170
Payable to carriers, net	38,111	13,566
Accrued expenses	281,525	401,735
Unearned revenues	1,347,717	-
Customer deposits	485,171	570,197
Total current liabilities	6,741,720	4,953,611
Note payable, net of current portion	12,557,081	14,235,792
Net pension liability	13,660,411	11,837,827
Total liabilities	32,959,212	31,027,230
Deferred inflows of resources:		
Deferred inflows from pension	1,331,405	1,775,894
Commitments and contingencies		
Net position:		
Net investment in capital assets	2,973,461	4,612,078
Restricted for:		
Debt service and reserve	250,171	250,146
Unrestricted	(7,740,576)	(6,531,049)
Total net position	(4,516,944)	(1,668,825)
Total liabilities, deferred inflows of resources and net position	$ 29,773,673	$ 31,134,299

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, 2021 and 2020

	2021	2020
Operating revenues:		
Cellular	$ 5,735,417	$ 6,189,716
Palaunet	2,933,215	3,129,431
Local	1,793,298	1,700,249
Digital television	1,105,636	1,227,625
Long distance	(85,351)	(16,391)
Miscellaneous	164,362	142,446
Provision for doubtful accounts	-	(104,816)
Total net operating revenues	11,646,577	12,268,260
Operating expenses:		
Plant specific:		
Operations	5,852,623	5,500,240
Depreciation	3,007,025	2,804,804
Corporate office	2,427,161	2,754,262
Customer service	1,544,352	1,629,054
Plant non-specific operations	758,337	854,868
Total operating expenses	13,589,498	13,543,228
Operating income loss	(1,942,921)	(1,274,968)
Nonoperating income (expense):		
Unrealized gain (loss) on investments	331,028	527,520
Grant Revenue	427,283	-
Income on investments	8,115	-
Contract termination costs	(791,812)	-
Other income (expense), net	(118,786)	(1,900)
Interest expense	(761,026)	(770,106)
Total nonoperating income (expense), net	(905,198)	(244,486)
Change in net position	(2,848,119)	(1,519,454)
Net position (deficit) at beginning of year	(1,668,825)	(149,371)
Net position (deficit) at end of year	$ (4,516,944)	$ (1,668,825)

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, 2021 and 2020

	2021	2020
Cash flows from operating activities:		
Cash received from customers	$ 12,017,851	$ 12,399,677
Cash payments to suppliers for goods and services	(9,628,436)	(8,110,812)
Cash payments to employees	(1,361,168)	(1,361,570)
Net cash provided by operating activities	1,028,247	2,927,295
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(2,209,153)	(1,742,784)
Additions from restricted cash and cash equivalents	(25)	(33)
Capital grant funds received	1,775,000	-
Interest paid	(761,026)	(770,106)
Repayment of long-term debt	(22,877)	(777,334)
Net cash used in financing activities	(1,218,081)	(3,290,257)
Cash flows from investing activities:		
Other income	(118,786)	(1,900)
Unrealized gain (loss) on investments	331,028	527,519
Proceeds from sale and maturities of investment securities	700,000	798,924
Loss on contract termination	(791,812)	-
Purchase of investment securities	(50,000)	(793,237)
Net cash used in investing activities	70,430	531,306
Net change in cash	(119,404)	168,344
Cash at beginning of year	465,082	296,738
Cash at end of year	$ 345,678	$ 465,082

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, 2021 and 2020

	2021	2020
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ (1,942,921)	$ (1,274,968)
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation	3,007,025	2,804,804
Pension cost	975,691	842,532
Unrealized gain on investments	(331,028)	(527,520)
Provision for doubtful accounts	-	104,816
Other income (expense), net	118,786	1,900
Realized gain on investments	(427,283)	-
Income on investments	(8,115)	-
(Increase) decrease in assets:		
Receivables:		
Trade	63,940	16,004
Related party	(203,220)	338,018
Carriers, net	140,569	208,540
Other receivable	(503,188)	15,575
Inventories	(102,778)	(4,052)
Prepaid expenses	108,494	(84,663)
Other noncurrent assets	-	6,473
Increase (decrease) in liabilities:		
Accounts payable	(1,034,751)	581,553
Payable to carriers, net	24,545	13,566
Accrued expenses	(120,210)	(63,526)
Customer deposits	(85,026)	(50,857)
Unearned revenues	1,347,717	(900)
Net cash provided by operating activities	$ 1,028,247	$ 2,927,295

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) members of a Board of Directors appointed by the President of the ROP, with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress).

The primary purpose of 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 supersedes 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 the 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, 2021 and 2020, PNCC has deferred outflows of resources and deferred inflows of resources that are included as a component of net position.

Restricted:

Restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. At December 31, 2021 and 2020, PNCC have deferred outflows of resources and deferred inflows of resources that was included as a component of restricted net position.

(2) Summary of Significant Accounting Policies, continued

A. Basis of Presentation, ccontinued

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, 2021 and 2020, PNCC did 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, 2021 and 2020, PNCC had deferred outflows of resources and deferred inflows of resources that are included as a 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 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.

(2) Summary of Significant Accounting Policies, continued

D. Budget, continued

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 year 2021 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.

E. 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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

Allowance for Doubtful Accounts

An analysis of the change in allowance for doubtful accounts for the years ended December 31, 2021 and 2020 is as follows:

	2021	2020
Balance at beginning of the year	$ 1,242,217	$ 1,135,951
Current year provision	120,475	106,266
Balance at end of year	$ 1,362,692	$ 1,242,217

Inventories

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

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 the amount of investments in any one issuer that represents five percent (5%) or more of total investments for the PNCC. At December 31, 2021 and 2020, 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, 2021 and 2020 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 than those of this investment 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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

Investments, continued

- 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 by 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.

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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

Investments, continued

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).

    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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

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

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, 2021 and 2020.

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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

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, 2021 and 2020, refundable deposit was $54,300 and $60,773, respectively, and are reflected as other noncurrent assets in the accompanying financial statements.

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, 2021 and 2020 accrued annual leave totaled $64,746 and $155,748, respectively, and is included in the Statements of Net Position as a component of accrued expenses. At December 31, 2021 and 2020, all compensated absences are current. For the years ended December 31, 2021 and 2020, annual vacation leave taken totaled $167,835 and $121,533, 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 funds received for network and infrastructure projects that will be recognized in future periods. These unearned revenues primarily relate to grants amounts received from the Republic of Palau and the United Nations Development Program in the amount of $1,295,000 and $480,000, respectively, which have not yet been fully earned. Of these amounts, PNCC recognized $427,283 as grant revenues as of December 31, 2021. Unearned revenues totaled $1,347,717 which represents the grant revenue not yet earned or realized, and classified as a liability as of December 31, 2021.

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.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

Customer Deposits, continued

These 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, 2021 and 2020, customer deposits totaled $485,171 and $570,197, respectively.

Advertising Costs

Advertising costs are expensed as incurred. For years ended December 31, 2021 and 2020, advertising costs totaled $130 and $3,082, respectively, and are included as a component of customer service operations expense reported in the Statements of Revenues, Expenses and Changes in Net Position.

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. PNCC determined the differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total pension liability, pension contributions made subsequent to the measurement date and changes in proportion and difference between PNCC pension contributions and proportionate share of contributions qualify for reporting in this category.

Deferred Inflows of Resources

In additions to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. PNCC has determined the difference between projected and actual earnings on pension plan investments qualify for reporting in this category.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

Pensions

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

Taxes

Based on the enactment of RPPL 1-40, PNCC is exempt from all national and state non-payroll taxes or fees. In accordance with RPPL 10-17 Telecommunications Regulatory Framework, the Bureau of Revenue and Taxation will be collecting 15% of gross revenue from any company providing telecommunications service in the Republic of Palau. This collection will be deposited into a restricted account, for payment pursuant to PNC Title 15, § 437. RPPL 10-17 has an effective date of March 1, 2018. Pursuant to RPPL 10-17, the Republic will assume the scheduled monthly payment to REA/RUS which is effective March 1, 2018.

In accordance with RPPL 10-17, PNCC shall continue to be a Public Corporation and shall be subject to the corporate laws of the Republic. Effective January 1, 2018, PNCC is subject to 4% gross revenue taxes. "Gross revenue tax" is 4% on the total gross of all business revenues or total sums of all receipts from sources within the Republic whether in the form of cash or property derived from business, from the exploitation of capital whether in the form of receipts from the disposition of capital assets, interests, dividends, royalties, rentals, fees or otherwise, however, such receipts may be labeled without deduction or offset of any kind or nature.

(2) Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Position, continued

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 resulting 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. At December 31, 2021, PNCC's net position is a negative $4,516,944, meaning that total assets exceeded total liabilities. 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, 2021, PNCC a had a negative change in net position totaling $2,848,119.

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.

F. New Accounting Standards

During the year ended December 31, 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement Nos. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in ach pronouncement as originally issues. In accordance with GASB Statement No. 95, management elected to postpone implementation of these Statements.

During the year ended December 31, 2021, PNCC implemented the following pronouncements:

- GASB Statement No. 84, *Fiduciary Activities*, which improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

- GASB Statement No. 50, *Majority Equity Interests – An Amendment of GASB Statements No. 14 and 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units.

- GASB Statement No. 93, *Replacement of Interbank Offered Rates*, which establishes accounting and reporting requirements related to the replacement of Interbank Offered Rates such as the London Interbank Offered Rate (LIBOR) for hedging derivative instruments. The provision removing LIBOR as an appropriate benchmark interest rate for the evaluation of the effectiveness of derivative instruments is effective for the December 31, 2021.

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

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. Management believes that the implementation of this Statement will have a material effect on the financial statements. GASB Statement No. 87 will be effective after December 15, 2022

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Pursuant to GASB Statement No. 95, GASB Statement No. 89 will be effective after December 31, 2022. Management believes that the implementation of this Statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

In May 2019, GASB issued Statement No. 91 *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Pursuant to GASB Statement No. 95, GASB Statement No. 91 will be effective for the year ended December 31, 2023. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature addressing practice issues that have been identified during the implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about effective date of Statement No. 87, *Leases*; for interim financial statements, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, Fiduciary Activities, to postemployment. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 are for year ending December 31, 2022. Management does not believe that the implementation of this Statement and Guide 2019-3 will have a material effect on the financial statements.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issue related to public-private and public-public partnership arrangements. This Statement also improves guidance for accounting and financial reporting for availability payment arrangements. GASB Statement No. 94 will be effective for the year ending December 31, 2023. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

In May 2020, GASB issued Statement No. 96, Subscription-Based Information Technology Arrangements. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users. This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-of-use subscription asset – an intangible asset and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBIT; and (4) requires note disclosures regarding a SBITA. GASB Statement No. 96 will be effective for the year ended December 31, 2023. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans – amendment of GASB Statement Nos. 14 and 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. GASB Statement No. 97 will be effective for the year ended December 31, 2022. Management does not believe that the implementation of this Statement will have a material effect on the PNCC's financial statements.

In October 2021, GASB issues Statement No. 98, *The Annual Comprehensive Financial Report*. This Statement establishes the term annual comprehensive financial report and its acronym ACFR. That new term and acronym replace instances of comprehensive annual financial report and its acronym in generally accepted accounting principles for state and local governments. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 98 will be effective for fiscal years December 15, 2021.

(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:

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, 2021 and 2020, the carrying amount of PNCC's cash balances was $345,678 and $465,082, respectively. The corresponding bank balances as of December 31, 2021 and 2020 were $365,298 and $487,590, respectively. From these deposits, $342,128 and $237,444, 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.

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments

Investment and related investment earnings are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined. The PNCC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles.

The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant observable inputs; Level 3 inputs are significant unobservable inputs. PNCC has the following fair value measurements:

		Fair Value Measurement Using		
Investments by fair value level	12/31/2021	Level 1	Level 2	Level 3
Fixed income securities:				
Corporate Bonds	$ 424,619	$ -	$ 424,619	$ -
U.S. Treasury	390,457	390,457	-	-
Federal Agencies	-	-	-	-
Equity securities:				
U.S. Equities	1,232,809	1,232,809	-	-
Non-U.S. Equities	207,105	207,105	-	-
Total investments by fair value level	$ 2,254,990	$ 1,830,371	$ 424,619	$ -
Investments measured at net asset value (NAV):				
Exchanged-traded funds	$ 55,433			
Investments measured at cost based measure:				
Money market funds	$ 43,434			
Total investments	$ 2,353,857			

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

		Fair Value Measurement Using		
Investments by fair value level	12/31/2020	Level 1	Level 2	Level 3
Fixed income securities:				
Corporate Bonds	$ 474,576	$ -	$ 256,129	$ -
U.S. Treasury	356,623	307,765	-	-
Federal Agencies	70,719	-	70,442	-
Equity securities:				
U.S. Equities	1,204,065	1,084,607	-	-
Non-U.S. Equities	496,318	225,014	-	-
Total investments by fair value level	$ 2,602,301	$ 1,617,386	$ 326,571	$ -
Investments measured at net asset value (NAV):				
Exchanged-traded funds	$ 29,882			
Investments measured at cost based measure:				
Money market funds	$ 79,941			
Total investments	$ 2,712,124			

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. 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 the abovementioned Section 22 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 $250,171 and $250,146 as of December 31, 2021 and 2020, respectively, were deposited in FDIC insured financial institutions.

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

Restricted Cash and Cash Equivalents, continued

On December 31, 2015, PNCC's Emergency Reserve Fund (the Fund) has been invested with Raymond James as the new investment consultant, which holds the investments in PNCC's name. The PNCC Board of Directors are 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

Fair Value Measurement of the Investments, continued

At December 31, 2021 and 2020, PNCC's investment portfolios at fair value are as follows:

	2021			2020		
	Allocation		Market	Allocation		Market
	Actual	Policy	Value	Actual	Policy	Value
Fixed income securities:						
Corporate Bonds			$ 424,619			$ 474,576
U.S. Treasury			390,457			356,623
Federal Agencies			-			70,719
Total fixed income	35%	36%	815,076	33%	36%	901,918
Equity securities:						
U.S. Equities	52%	43%	1,232,809	40%	43%	1,204,065
Non-U.S. Equities	9%	19%	207,105	18%	19%	496,318
Total equity securities			1,439,914			1,700,383
Exchange-traded funds	1%	1%	55,433	1%	1%	29,882
Cash and cash equivalents	3%	1%	43,434	3%	1%	79,941
Total investments	100%	100%	$ 2,353,857	95%	100%	$ 2,712,124

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

At December 31, 2021 and 2020, PNCC's fixed income securities had the following ratings and maturities:

As of December 31, 2021

		Investment maturities (in years)				Rating	
Investment type	Fair Value	Less than 1	1-5	6-10	More than 10	Moody	Standard & Poor
Corporate bonds	$ 25,857	$ -	$ -	$ 25,857	$ -	Baa2	BBB
Corporate bonds	24,330	-	-	-	24,330	A2	A-
Corporate bonds	24,274	-	24,274	-	-	Baa2	BBB
Corporate bonds	25,829	-	-	25,829	-	Baa2	BBB
Corporate bonds	24,534	-	-	24,534	-	Baa3	BBB
Corporate bonds	24,082	-	-	24,082	-	Baa2	BBB
Corporate bonds	26,131	-	-	26,131	-	A3	A-
Corporate bonds	25,807	-	-	25,807	-	A2	BBB+
Corporate bonds	24,722	-	-	24,722	-	Baa1	BBB
Corporate bonds	25,350	-	-	-	25,350	A2	A-
Corporate bonds	23,901	-	-	23,901	-	Baa2	BBB
Corporate bonds	25,456	-	-	-	25,456	Aaa	AAA
Corporate bonds	24,180	-	-	24,180	-	Baa2	BBB+
Corporate bonds	26,235	-	-	-	26,235	Baa1	BBB+
Corporate bonds	24,712	-	-	24,712	-	A3	A-
Corporate bonds	25,041	-	-	25,041	-	Baa2	BBB
Corporate bonds	24,178	-	24,178	-	-	A1	BBB+
U.S. Treasury	33,509	-	-	-	33,509	Aaa	No rating
U.S. Treasury	42,645	-	-	-	42,645	Aaa	No rating
U.S. Treasury	41,433	-	-	41,433	-	Aaa	No rating
U.S. Treasury	25,039	-	25,039	-	-	Aaa	No rating
U.S. Treasury	41,269	-	41,269	-	-	Aaa	No rating
U.S. Treasury	33,344	-	33,344	-	-	Aaa	No rating
U.S. Treasury	40,881	-	-	40,881	-	Aaa	No rating
U.S. Treasury	24,851	-	24,851	-	-	Aaa	No rating
U.S. Treasury	24,675	-	24,675	-	-	Aaa	No rating
U.S. Treasury	41,633	-	-	41,633	-	Aaa	No rating
U.S. Treasury	41,178	-	-	41,178	-	Aaa	No rating
Total	$ 815,076	$ -	$ 197,630	$ 439,921	$ 177,525		

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

As of December 31, 2020

		Investment maturities (in years)				Rating	
Investment type	Fair Value	Less than 1	1-5	6-10	More than 10	Moody	Standard & Poor
Corporate bonds	$ 27,431	$ -	$ -	$ 27,431	$ -	Baa2	BBB
Corporate bonds	27,200	-	-	27,200	-	A2	A-
Corporate bonds	27,786	-	-	27,786	-	Baa3	BBB
Corporate bonds	27,369	-	-	27,369	-	Baa2	BBB
Corporate bonds	27,805	-	-	27,805	-	Baa3	BBB
Corporate bonds	27,652	-	-	27,652	-	A3	A-
Corporate bonds	27,687	-	-	27,687	-	A3	A-
Corporate bonds	28,130	-	-	28,130	-	Baa2	BBB
Corporate bonds	27,389	-	-	27,389	-	Baa2	BBB
Corporate bonds	29,737	-	-	29,737	-	Baa1	BBB
Corporate bonds	27,981	-	-	27,981	-	A2	A-
Corporate bonds	27,993	-	-	27,993	-	Baa2	BBB
Corporate bonds	27,418	-	-	-	27,418	Aaa	AAA
Corporate bonds	28,425	-	-	-	28,425	Baa1	BBB+
Corporate bonds	28,006	-	-	28,006	-	A3	A-
Corporate bonds	28,868	-	-	-	28,868	Baa2	BBB
Corporate bonds	27,699	-	-	27,699	-	A2	BBB+
Federal agencies	70,719	-	70,719	-	-	Aaa	AA+
U.S. Treasury	45,298	-	-	-	45,298	Aaa	No rating
U.S. Treasury	35,358	-	-	-	35,358	Aaa	No rating
U.S. Treasury	46,344	-	-	46,344	-	Aaa	No rating
U.S. Treasury	27,419	-	-	27,419	-	Aaa	No rating
U.S. Treasury	37,129	-	37,129	-	-	Aaa	No rating
U.S. Treasury	46,425	-	-	46,425	-	Aaa	No rating
U.S. Treasury	45,024	-	45,024	-	-	Aaa	No rating
U.S. Treasury	27,626	-	27,626	-	-	Aaa	No rating
U.S. Treasury	46,000	-	-	46,000	-	Aaa	No rating
Total	$ 901,918	$ -	$ 180,498	$ 556,053	$ 165,367		

(4) Capital Assets

PNCC's capital assets for the years ended December 31, 2021 and 2020 are summarized below as follows:

	Balance at December 31, 2020	Additions	Transfers/ Retirements	Balance at December 31, 2021
Regulated capital assets				
Cables and transmission lines	$ 28,474,413	$ -	$ -	$ 28,474,413
Transmission equipment	9,749,475	150,350	-	9,899,825
Buildings	10,009,247	38,028	-	10,047,275
Central office equipment	4,570,696	182,338	-	4,753,034
General support equipment	2,719,202	142,886	-	2,862,088
Customer premises wiring and equipment	1,569,727	-	-	1,569,727
Vehicles	847,148	3,700	-	850,848
Furniture and fixtures	36,806	-	-	36,806
Regulated capital assets, at cost	57,976,714	517,302	-	58,494,016
Accumulated depreciation	(46,449,017)	(1,782,018)	-	(48,231,035)
Regulated capital assets, at net book value	11,527,697	(1,264,716)	-	10,262,981
Non-regulated capital assets				
Cable television	3,657,148	41,330	-	3,698,478
Cellular	15,389,034	127,776	-	15,516,810
Palaunet	2,303,477	77,859	-	2,381,336
Non-regulated capital assets, at cost	21,349,659	246,964	-	21,596,623
Accumulated depreciation	(12,228,228)	(1,225,007)	-	(13,453,235)
Non-regulated capital assets, at net book value	9,121,431	(978,043)	-	8,143,388
Construction in progress	556,685	2,234,674	(1,653,410)	1,137,950
Total	$ 21,205,813	$ (8,084)	$ (1,653,410)	$ 19,544,319

(4) Capital Assets, continued

	Balance at December 31, 2019	Additions	Transfers/ Retirements	Balance at December 31, 2020
Regulated capital assets				
Cables and transmission lines	$ 28,009,294	$ 465,119	$ -	$ 28,474,413
Transmission equipment	9,749,475	-	-	9,749,475
Buildings	10,005,059	4,188	-	10,009,247
Central office equipment	3,504,117	1,066,579	-	4,570,696
General support equipment	2,454,836	264,366	-	2,719,202
Customer premises wiring and equipment	1,456,018	113,709	-	1,569,727
Vehicles	823,053	24,095	-	847,148
Furniture and fixtures	34,013	2,793	-	36,806
Regulated capital assets, at cost	56,035,865	1,940,849	-	57,976,714
Accumulated depreciation	(44,923,306)	(1,525,711)	-	(46,449,017)
Regulated capital assets, at net book value	11,112,559	415,138	-	11,527,697
Non-regulated capital assets				
Cable television	3,526,496	130,652	-	3,657,148
Cellular	13,873,069	1,515,965	-	15,389,034
Palaunet	2,146,840	156,637	-	2,303,477
Non-regulated capital assets, at cost	19,546,405	1,803,254	-	21,349,659
Accumulated depreciation	(10,949,135)	(1,279,093)	-	(12,228,228)
Non-regulated capital assets, at net book value	8,597,270	524,161	-	9,121,431
Construction in progress	2,558,003	1,742,784	(3,744,102)	556,685
Total	$ 22,267,832	$ 2,682,083	$ (3,744,102)	$ 21,205,813

Depreciation expense for the years ended December 31, 2021 and 2020 was $3,007,025 and $2,804,804, 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, 2021 and 2020, amounts due from the Republic of Palau and its component units totaled $573,000 and $391,212, respectively.

(6) Long-term Debt

Long-term debt as of December 31, 2021 and 2020 are summarized below:

	2021	2020
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 of PNCC's assets and a pledge of its revenues.	$ 16,570,858	$ 16,593,735
Less current portion	(4,013,777)	(2,357,943)
Long-term debt, net of current portion	$ 12,557,081	$ 14,235,792

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.

On July 31, 2020, PNCC entered into a Deferral Agreement with RUS. Principal payments were deferred for 12 months commencing July 2020 and PNCC is only required to interest payments for that period. After the principal deferment period July 2021, an additional deferment period up to December 31st, 2021 was agreed between PNCC and RUS. After the deferment period elapses, PNCC will resume monthly principal and interest payments until maturity. The principal amount deferred will be re-amortized after the deferment period. The negative loan covenants require PNCC to submit monthly and quarterly financials, monthly billings and collection reports, balances of accounts receivable and accounts payable, and the number of customers by service offering type. PNCC is not allowed to issue bonuses or increments during the deferment period.

The management of PNCC believes it is in compliance with the RUS mortgage loan covenants at December 31, 2021 and 2020.

(6) Long-term Debt, continued

Future minimum principal and interest payments for the RUS mortgage are as follows:

Years ending December 31,	Principal	Interest	Total
2022	$ 1,422,815	$ 882,957	$ 2,305,772
2023	1,521,388	784,384	2,305,772
2024	1,625,276	680,496	2,305,772
2025	1,734,840	570,932	2,305,772
2026	1,850,470	455,302	2,305,772
2027-2029	8,416,069	604,063	9,020,132
	$ 16,570,858	$ 3,978,134	$ 20,548,992

At December 31, 2021 and 2020, the changes in the long-term liabilities are as follows:

	Balance January 1, 2021	Additions	Reductions	Balance December 31, 2021	Current	Noncurrent
Rural Utilities Services	$ 16,593,735	$ -	$ 22,877	$ 16,570,858	$ 4,013,777	$ 12,557,081
Net Pension Liability	11,837,827	1,822,584	-	13,660,411	-	13,660,411
	$ 28,431,562	$ 1,822,584	$ 22,877	$ 30,231,269	$ 4,013,777	$ 26,217,492

	Balance January 1, 2020	Additions	Reductions	Balance December 31, 2020	Current	Noncurrent
Rural Utilities Services	$ 17,371,069	$ -	$ 777,334	$ 16,593,735	$ 2,357,943	$ 14,235,792
Net Pension Liability	8,712,379	3,125,448	-	11,837,827	-	11,837,827
	$ 26,083,448	$ 3,125,448	$ 777,334	$ 28,431,562	$ 2,357,943	$ 26,073,619

Interest expense paid in 2021 and 2020 amounted to $761,026 and $770,106, respectively.

(7) Pension Plan

General Information About the Pension Plan:

Plan Description:

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

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

Membership:

The ROP National Government, ROP State Governments and ROP public corporations, quasi-governmental organizations and other public entities of the National and State Governments of ROP, are participating in the Fund. Membership consists of the following as of October 1, 2019 (the valuation date):

Inactive members or beneficiaries currently receiving benefits	1629
Inactive members entitled to but not yet receiving benefits	270
Inactive nonvested members	982
Active members	3480
Total members	6361

Summary of the Principal Provisions of the Plan:

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

Service:

Vesting Service: Includes membership service and prior service credit.

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

(7) Pension Plan, continued

General Information About the Pension Plan:

Pension Benefits:

Service, continued

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

Retirement benefits are paid to members who are required, with certain exceptions, to retire no later than their sixtieth birthday or after 30 years of service. A member may retire after his or her fifty-fifth birthday at a reduced pension amount if the member has completed at least 20 years of government employment. A married member of a former member receiving a distribution of benefits under the Pension Fund receives reduced benefit amounts to provide survivors' benefits to his or her spouse. An unmarried member or former member may elect to receive a reduced benefit amount during his or her lifetime with an annuity payable to he or her designated beneficiary. Disability benefits are paid to qualified members for the duration of the disability. Effective May 17, 1996, through RPPL 4-49, members, who have twenty-five years or more of total service, are eligible for retirement regardless of their age and, upon such retirement, are eligible to receive pension benefits at a level established by the Board. Effective July 1, 1999, pursuant to RPPL 4-49 and RPPL 5-30, retirement is mandatory for all members who have thirty years or more of total service and all employees who are sixty years of age or older with certain exceptions. Beginning October 1, 2003, pursuant to RPPL 6-37, mandatory retirement may be delayed for up to five years, by specific exemption by the Board. In December 2008. RPPL 7-56 eliminated early retirement and thirty-year mandatory service provisions. These provisions were restored through RPPL 8-10 in October 2009. On April 30, 2013, RPPL 9-2 eliminated the mandatory service retirement after thirty years of service. After December 31, 2013, no employee shall be entitled to pension benefits until reaching the age of sixty.

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

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Pension Benefits, continued:

Currently, normal benefits are paid monthly and are 2% of each member's average monthly salary for each year of credited total service up to a maximum of thirty years total service. The average annual salary is the average of the highest three consecutive fiscal years of compensation received by a member during his or her most recent then full fiscal years of service. For members who have not completed three consecutive fiscal years of employment during his or her most recent ten full fiscal years of service, the average annual salary is the average monthly salary during the term of the member's service multiplied by twelve.

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

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

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

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

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

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Pension Benefits, continued:

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

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

- If the member is an employee at his or her date of death and a spouse or beneficiary survives, the total death benefits payable shall be the actuarial equivalent of the greater of 3 times the member's average annual salary or the member's present value of accrued benefit.

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

- If the former member is not an employee at the date of death, a refund of the total amount of contributions made by the member.

- If the member was an employee at the date of death and had completed one year or more of total service, the estate of the member shall be entitled to a death benefit equal to the greater of three times the member's annual salary or the present value of the member's accrued benefit payable in the form of a single lump sum payment.

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

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Membership Contributions

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

Employer and Other Contributions

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

Actuarial Assumptions and Other Inputs

The total pension liability was determined by an actuarial valuation as of October 1, 2019, rolled forward on year to September 30, 2020, using the following actuarial assumptions and other inputs:

Actuarial Cost Method:	Normal costs are calculated under the entry age normal method
Amortization Method:	Level dollar, open with remaining amortization period of 30 years
Asset Valuation Method:	Market Value of Assets
Long-term Expected Rate of Return:	6.74% per year, net of investment expenses, and price inflation
Municipal Bond Index Rate:	2.22%

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Actuarial Assumptions and Other Inputs, continued

Year fiduciary net position is projected to be depleted:	2025
Price Inflation:	2.5% per year
Interest on Member Contribution:	5% per year
Salary Increase:	3% per year
Expenses:	$300,000 annually added to normal cost
Mortality:	RP 2000 Combined Mortality Table, set forward four years for all members except disability recipients, where the table is set forward ten years.
Termination of Employment:	5% for ages 20 to 39, none for all other ages.

Disability:

Age	Disability
25	0.21%
30	0.18%
35	0.25%
40	0.35%
45	0.50%
50	0.76%
55	1.43%
60	2.12%

Retirement Age:	100% at age 60
Form of Payment:	Single: Straight life annuity; Married: 100% joint and survivor
Marriage Assumption:	80% of the workers are assumed to be married and males are assumed to be 3 years older than their spouses. Beneficiaries are assumed to be the opposite gender of the member.
Duty vs Non-Duty Related Disability:	100% duty related
Refund of Contributions:	80% terminated vested members elect a refund of contributions

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Actuarial Assumptions, continued

Investment Rate of Return

The long-term expected rate of return on the Fund's investment of 6.74% was determined using log-normal distribution analysis, creating a best-estimate range for each asset class.

As of September 30, 2020, the arithmetic real rates of return for each major investment class are as follows:

Assets Class	Target Allocation	Expected Rate of Return
US Large Cap Value Equity	10%	8.70%
US Large Cap Growth Equity	10%	9.13%
Mature Markets Non-U.S. Equity	15%	9.19%
Emerging Markets Non-U.S. Equity	10%	12.52%
U.S. Core Fixed Income	35%	3.82%
Global Fixed Income	10%	3.40%
Global REIT	10%	8.33%
	100%	

Discount Rate

The discount rate used to measure the total pension liability was 2.28% at the current measurement date and 2.85% at the prior measurement date. The discount rate was determined using the current assumed rate of return of 6.74% until the point where the plan fiduciary net position is negative. Using the current contribution rates, a negative position happens in 2025. For years on or after 2025, the Municipal Bond Index Rate a discount rate of 2.22% was used. The Municipal Bond Index Rate from the prior measurement date was 2.81%.

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Sensitivity of Net Pension Liability to Changes in the Discount Rate

The following schedule presents PNCC's proportionate share of the net pension liability as of September 30, 2020, calculated using the discount rate of 2.28%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1% lower (1.28%) or 1% higher (3.28%) from the current rate.

	1% Decrease in Discount Rate 1.28%	Current Discount Rate 2.28%	1% Increase in Discount Rate 3.28%
Net Pension Liability	$ 15,941,916	$ 13,660,411	$ 11,778,598

Deferred Outflows and Inflows of Resources

At December 31, 2021 and 2020, PNCC reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2021		2020	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 459,789	$ 361,355	$ 601,998	$ 461,505
Net difference between projected and actual earnings on pension plan investments	25,523	17,486	32,922	28,100
Change in assumptions	2,931,314	858,672	2,456,732	1,079,198
PNCC contributions subsequent to the measurement date	-	-	-	-
Changes in proportion and difference between the Authority contribution and proportionate shares of contributions	1,270,243	93,892	1,192,813	207,091
Total	$ 4,686,869	$ 1,331,405	$ 4,284,465	$ 1,775,894

(7) Pension Plan, continued

General Information About the Pension Plan, continued:

Deferred outflows resulting from contributions subsequent to measurement date will be recognized as reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions at December 31, 2020 will be recognized in pension expense as follows:

Year ending December 31,	
2021	$ 679,190
2022	729,216
2023	601,222
2024	554,833
2025	603,529
Thereafter	187,474
	$3,355,464

Medical and Life Insurance Benefit

In April 2010, the Republic of Palau (ROP) enacted RPPL 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, 2021, 2020 and 2019, PNCC's employer's share paid to the Social Security Administration for these costs was $203,655, $249,210 and $239,844, respectively, and is included as a component of payroll burden in the Schedule of Functional Expenses.

(8) Contract Termination Costs

During September 2021, PNCC entered into a Master Services Agreement contract with a vendor to replace its Mobile Core Network and provide telecommunications technical implementation and management services. The total contract price was $2,590,000, of which, 50% or $1,295,000 was paid to the vendor upon signing the contract. Subsequent to the award of the contract and remittance of the initial payment, it was determined that PNCC failed to fully adhere with its procurement policies and regulations in awarding the contract. During December 2021, PNCC and the vendor negotiated an Agreement Regarding Termination of Contract and Mutual Release requiring the vendor to itemize all expenses incurred in connection with the work performed up to the date of contract termination. The parties agreed that the vendor would deduct all pertinent expenses incurred from the initial down payment and remit the remaining balance of $503,188 to PNCC. Due to the unique nature and customization of the equipment provided by the vendor, PNCC was unable to utilize or resale the equipment despite numerous attempts. As a result, PNCC recognized a loss of $791,812 on the termination of the contract as of December 31, 2021, as follows:

Initial 50% contract payment	$ 1,295,000
Less amount due to PNCC	(503,188)
Loss on contract termination	$ 791,812

The loss on the termination of the contract is reported as a nonoperating expense on the Statements of Revenues, Expenses and Changes in Net Position. The amount of $503,188 is reported as other receivables on the Statements of Net Position.

(9) Commitments and Contingencies

Commitments

The Company entered in a five-year lease agreement effective May 24, 2019 and expiring May 23, 2024. The Company was required to make an advance payment of $200,000, then commencing on the third year, the Company is required to make payments of $12,000 per month payable in advance by no later than the 10^{th} day of each month.

The Company has a lease on a land easement agreement effective of May 21, 2019 and expiring May 20, 2024. The agreement calls for monthly payments of $182. Rent under this lease is recognized at $2,220 per year.

The Company has a lease on a land easement agreement effective of March 1, 2019 and expiring March 1, 2024. The agreement calls for monthly payments of $700. Rent under this lease is recognized at $8,400 per year.

The Company has a lease on a land easement agreement effective of March 1, 2019 and expiring March 1, 2024. The agreement calls for monthly payments of $700. Rent under this lease is recognized at $8,400 per year.

(9) Commitments and Contingencies, continued

The Company has a lease on a land easement agreement effective of August 8, 2019 and expiring August 7, 2027. The agreement calls for monthly payments of $1,000. Rent under this lease is recognized at $12,000 per year.

The Company entered into a five-year network equipment maintenance agreement effective March 1, 2019 and expiring March 1, 2024. The agreement calls for annual commitments of $2,980.

The Company entered into a three-year broadcast connectivity agreement effective October 14, 2019 and expiring October 14, 2022. The agreement calls for quarterly payments of $540. The service fee is recognized at $2,160 per year.

The Company entered into a three-year broadcast connectivity agreement effective August 22, 2019 and expiring August 22, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a three-year broadcast connectivity agreement effective August 16, 2019 and expiring August 15, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a three-year broadcast connectivity agreement effective December 12, 2019 and expiring December 11, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a broadcaster licensing agreement effective September 1, 2019 and expiring June 30, 2022. The agreement calls for an annual payment of $500.

The Company entered into a security service agreement effective April 1, 2021 and expiring May 31, 2022. The agreement calls for monthly payments of $6,500. The service fee is recognized at $78,000 per year.

Future minimum lease and service payments are as follows:

2022	$ 295,576
2023	199,440
2024	174,100
2025	12,000
2026	12,000
Thereafter	8,000
	$ 701,116

(9) Commitments and Contingencies, continued

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, 2021 and 2020 was $1,174,025 and $1,287,818, respectively.

(10) 401(k) Profit Sharing Plan

PNCC has adopted a retirement plan (a "401(k) plan) which covers substantially all employees meeting certain eligibility requirements. Participants may contribute a portion of their pretax income into a retirement fund. At the Company's discretion, participants' contributions are matched up to 5% by the Company. For the years ended December 31, 2021 and 2020, the Company's discretionary profit-sharing contribution were $48,587 and $44,683, respectively. The contributions are recorded as a component of plant specific operations expenses reported in the Statement of Revenues, Expenses and Changes in net position.

(11) 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, 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 portion of long-term debt approximate their fair values based on their short-term nature. The recorded value of customer deposits approximates its fair value as 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.

(12) Reclassifications

Certain amounts presented in 2020 have been reclassified to conform to the 2021 financial statement presentation. These reclassifications did not affect the change in net position or the total net position.

(13) COVID-19

In December 2019, an outbreak of a novel strain of coronavirus (COVID-19) originated in Wuhan, China and has since spread to other countries, including the U.S and throughout Micronesia. On March 11, 2020, the World Health Organization characterized COVID-19 as a pandemic. In addition, multiple jurisdictions in the U.S. have declared a state of emergency. It is anticipated that these impacts will continue for some time. Future potential impacts may include disruptions on the Company's employees' ability to work or the customers' ability to pay monthly services. Changes to the operating environment may increase operating costs. Additional impacts may include the ability of customers to continue making payments as a result of job loss or other pandemic related issues. The future effects of these issues are unknown.

(14) Subsequent Event

During September 2022, PNCC was awarded a grant in the amount of $34,991,340 from the United States Department of Agriculture (USDA) under the ReConnect Loan and Grant Program. This USDA program provides loans, grants, and loan/grant combinations of funds for the costs of construction, improvement, or acquisition of facilities and equipment needed to provide broadband service in eligible rural areas.

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

SUPLEMENTARY SCHEDULES

Year Ended December 31, 2021

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

Supplementary Information
Schedule of Budget vs Actual (GAAP Basis)
For the Year Ended December 31, 2021

	Budget				Variance
	Original	Revisions	Final	Actual	Favorable (Unfavorable)
Operating revenues:					
Cellular	$ 5,986,978	$ -	$ 5,986,978	$ 5,735,417	$ (251,561)
Palaunet	3,185,059	-	3,185,059	2,933,215	(251,844)
Digital television	1,241,921	-	1,241,921	1,793,298	551,377
Local	1,526,456	-	1,526,456	1,105,636	(420,820)
Long distance	187,964	-	187,964	(85,351)	(273,315)
Miscellaneous	559,826	-	559,826	164,362	(395,464)
Provision for doubtful accounts	-	-	-	-	-
Total operating revenues	12,688,204	-	12,688,204	11,646,577	(1,041,627)
Operating expenses:					
Plant specific operations	5,183,157	-	5,183,157	5,852,623	(669,466)
Depreciation	2,196,761	-	2,196,761	3,007,025	(810,264)
Customer service operations	1,389,964	-	1,389,964	2,427,161	(1,037,197)
Corporate operations	2,131,698	-	2,131,698	1,544,352	587,346
Plant non-specific operations	896,888	-	896,888	758,337	138,551
Total operating expenses	11,798,468	-	11,798,468	13,589,498	(1,791,030)
Operating income	889,736	-	889,736	(1,942,921)	(2,832,657)
Non-operating income (expenses):					
Interest expense	-	-	-	(761,026)	(761,026)
Unrealized gain on investment	(48,638)	-	(48,638)	331,028	379,666
Realized gain on investments	(134,207)	-	(134,207)	-	134,207
Contract termination costs	-	-	-	(791,812)	(791,812)
Grant revenue	-	-	-	427,283	427,283
Gain (loss) on disposal of equipment	-	-	-	8,115	8,115
Other expense	142,844	-	142,844	(118,786)	(261,630)
Total nonoperating expenses, net	(40,001)	-	(40,001)	(905,198)	(865,197)
Change in net position	$ 849,735	$ -	$ 849,735	$ (2,848,119)	$ (3,697,854)

See accompanying independent auditor's report.

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

Supplementary Schedule of Functional Expenses
For The Year Ended December 31, 2021
(With Comparative Totals for 2020)

	Plant Specific					Plant	Total	
	Depreciation	Operations	Corporate	Customer Relations	Total	Non-Specific Operations	Operating Expenses 2021	2020
Outside services	$ -	$ 3,624,877	$ 222,822	$ 550,593	$ 4,398,292	$ 3,603	$ 4,401,895	$ 4,419,102
Depreciation	3,007,025	-	-	-	3,007,025	-	3,007,025	2,804,804
Others	-	38,286	72,074	44,733	155,093	41,321	196,414	1,372,127
Salaries and wages	-	1,356,095	1,045,952	580,903	2,982,950	342,923	3,325,873	1,361,570
Utilities	-	466,418	-	-	466,418	-	466,418	597,352
Materials and supplies	-	177,307	19,235	6,586	203,128	30,741	233,869	592,206
Bad debts	-	-	120,474	-	120,474	-	120,474	504,756
Gross revenue taxes	-	-	413,921	-	413,921	-	413,921	456,737
Clearance	-	10,462	-	-	10,462	1,622	12,084	196,964
Insurance	-	-	82,168	-	82,168	-	82,168	143,909
Legal fees	-	-	47,700	-	47,700	-	47,700	59,580
Fuel	-	67,955	11,074	5,674	84,703	8,014	92,717	58,044
Training	-	394	11,338	10,173	21,905	407	22,312	41,275
Office supplies	-	1,668	13,496	13,072	28,236	2,280	30,516	40,335
Postage	-	-	29,056	-	29,056	-	29,056	30,849
Payroll burden	-	88,191	350,581	327,907	766,679	327,426	1,094,105	856,146
Board fees	-	-	12,950	-	12,950	-	12,950	7,472
Rent	-	-	-	-	-	-	-	-
Allocation	-	20,970	(25,680)	4,711	1	-	1	-
	$ 3,007,025	$ 5,852,623	$ 2,427,161	$ 1,544,352	$ 12,831,161	$ 758,337	$ 13,589,498	$ 13,543,228

See accompanying independent auditor's report.

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, 2021
(With Comparative Totals for 2020)

	Depreciation	Operations	Corporate	Customer Relations	Total Operating Expenses By Division 2021	Total Operating Expenses By Division 2020
Telephony:						
Outside services	$ -	$ 2,980,997	$ 222,822	$ 45,423	$ 3,249,242	$ 3,040,565
Depreciation	1,782,018	-	-	-	1,782,018	1,525,711
Salaries and wages	-	597,187	1,045,952	579,896	2,223,035	1,130,367
Others	-	4,126	72,074	2,666	78,866	622,928
Utilities	-	466,418	-	-	466,418	570,248
Bad debts	-	-	120,474	-	120,474	504,756
Business gross revenue tax	-	-	413,921	-	413,921	456,737
Materials and supplies	-	131,671	19,235	6,586	157,492	240,148
Clearance	-	6,132	-	-	6,132	197,848
Insurance	-	-	82,168	-	82,168	143,909
Legal fees	-	-	47,700	-	47,700	59,580
Fuel	-	50,455	11,074	5,674	67,203	46,630
Office supplies	-	1,226	13,496	13,072	27,794	37,260
Postage	-	-	29,056	-	29,056	30,849
Training	-	107	11,338	10,173	21,618	30,238
Board fees	-	-	12,950	-	12,950	7,472
Payroll burden	-	12,718	350,581	327,907	691,206	561,688
Allocation	-	-	(25,680)	(36,081)	(61,761)	-
	1,782,018	4,251,037	2,427,161	955,316	9,415,532	9,206,934
Cellular:						
Depreciation	873,292	-	-	-	873,292	884,634
Outside services	-	6,075	-	-	6,075	80,512
Others	-	22,049	-	42,000	64,049	66,289
Materials and supplies	-	4,986	-	-	4,986	1,875
Training	-	-	-	-	-	343
Salaries and wages	-	86,780	-	-	86,780	-
Payroll burden	-	-	-	-	-	-
Allocation	-	-	-	29,452	29,452	-
	873,292	119,890	-	71,452	1,064,634	1,033,653
Palaunet:						
Outside services	-	637,485	-	-	637,485	649,545
Others	-	580	-	-	580	215,698
Depreciation	179,209	-	-	-	179,209	176,156
Training	-	120	-	-	120	710
Materials and supplies	-	3,384	-	-	3,384	672
Salaries and wages	-	182,581	-	-	182,581	-
Payroll burden	-	75,053	-	-	75,053	-
Clearance	-	1,208	-	-	1,208	-
Allocation	-	20,970	-	-	20,970	-
	179,209	921,381	-	-	1,100,590	1,042,781
Digital TV:						
Outside services	-	320	-	505,170	505,490	646,704
Materials and supplies	-	37,266	-	-	37,266	331,978
Depreciation	172,507	-	-	-	172,507	218,303
Others	-	11,531	-	67	11,598	190,429
Fuel	-	17,500	-	-	17,500	11,394
Training	-	167	-	-	167	7,198
Office supplies	-	442	-	-	442	86
Clearance	-	3,122	-	-	3,122	(1,100)
Salaries and wages	-	489,547	-	1,007	490,554	-
Payroll burden	-	420	-	-	420	-
Allocation	-	-	-	11,340	11,340	-
	172,507	560,315	-	517,584	1,250,406	1,404,992
	$ 3,007,025	$ 5,852,623	$ 2,427,161	$ 1,544,352	$ 12,831,161	$ 12,688,360

See accompanying independent auditor's report.

Palau National Communications Corporation
(A Component Unit of the Republic of Palau)

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

	2020	2019	2018	2017	2016	2015	2014
Civil Service Pension Trust Fund (Plan) total net pension liability	$ 344,384,167	$ 308,480,463	$ 250,868,784	$ 259,395,005	$ 249,453,960	$ 215,546,176	$ 204,281,232
PNCC proportionate share of the net pension liability	$ 13,660,411	$ 11,837,827	$ 8,712,379	$ 8,539,634	$ 7,980,506	$ 7,015,927	$ 7,163,121
PNCC proportionate share of the net pension liability	3.967%	3.837%	3.473%	3.292%	3.199%	3.255%	3.506%
PNCC's covered-employee payroll**	$ 2,432,700	$ 2,293,283	$ 2,037,433	$ 1,907,250	$ 1,694,398	$ 1,578,557	$ 1,648,460
PNCC's proportionate share of the net pension liability as a percentage of its covered employee payroll	561.53%	516.20%	427.62%	447.75%	470.99%	444.45%	434.53%
Plan Fiduciary net position as a pencentage of the total pension liability	8.42%	8.26%	10.24%	10.18%	10.55%	11.54%	14.01%

* This data is presented for those years for which information is available.
** Covered-employee payroll data from the actuarial valuation date with a one-year lag.

See accompanying independent auditor's report.

Palau National Communications Corporation
(A Component Unit of the Republic of Palau)

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

	2020	2019	2018	2017	2016	2015	2014
Actuarially determined contribution	$ 624,933	$ 540,730	$ 601,245	$ 565,547	$ 461,242	$ 354,787	$ 372,513
Contribution in relation to the actuarially determined contribution	145,962	137,597	122,246	114,435	100,271	94,083	97,071
Contribution (excess) deficiency	$ 478,971	$ 403,133	$ 478,999	$ 451,112	$ 360,971	$ 260,704	$ 275,442
PNCC's covered-employee payroll**	$ 2,432,700	$ 2,293,283	$ 2,037,433	$ 1,907,250	$ 1,694,398	$ 1,578,557	$ 1,648,460
PNCC's proportionate share of the net pension liability	6.00%	6.00%	6.00%	6.00%	5.92%	5.96%	5.89%

* This data is presented for those years for which information is available.
** Covered-employee payroll data from the actuarial valuation date with a one-year lag.

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

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND ON COMPLIANCE

Year Ended December 31, 2021

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

To the Board of Directors
Palau 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 Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statement of net position as of December 31, 2021, and the related statement of revenues, expenditures 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 February 3, 2023.

Report on 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) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PNCC's internal control. Accordingly, we do not express an opinion on the effectiveness of PNCC's internal control.

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

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified certain deficiencies in internal control, described in the accompanying schedule of findings and responses as items 2021-001 that we consider to be material weakness.

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Report on 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 financial statements. 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as finding 2021-001.

PNCC's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on PNCC's response to the findings identified in our audit and described in the accompanying schedule of findings and questioned costs. PNCC's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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
February 3, 2023

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's 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?	_____ yes __X__ no
• Noncompliance material to financial statements?	_____ yes __X__ no

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2021-001
Area: Procurement

Criteria:

Pursuant to PNCC's procurement policy regulations Section II for Procurement by Competitive Sealed Bidding, contracts shall be awarded by competitive sealed bids except as otherwise provided by law. Invitation for bids shall contain a clear, complete and accurate description of the goods or services to be procured. This description shall not contain unnecessary restrictive requirements which may unduly limit the number of bidders.

A bid may be rejected for any of the following reasons as determined by the Procurement Officer concerned in writing:

A. failure to comply with material requirements of the invitation for bids such as specifications or time of delivery;
B. imposition of conditions by the bidder, which conditions limit the bidder's liability or modify requirements for the invitation. For example, bids may be rejected when the bidder:
    1. protects against future changes in conditions, such as increased cost; or
    2. fails to state a definite price; or
    3. states a price but qualifies it as subject to price in effect at time of [delivery]; or
    4. limits the rights of the government; or
    5. is nonresponsive.

Furthermore, when a contract involving construction in excess of $100,000 is awarded, a performance bond acceptable to PNCC, executed by a surety acceptable to PNCC, in an amount equal to 10% of the price specified in the contract will be delivered to PNCC by the contractor and will be binding on the parties upon execution of the contract.

The General Manager may reduce the performance bond requirements for any construction contracts awarded in excess of $250,000, provided the General Manager determines that a lesser amount is sufficient to protect PNCC's interests; provide that in no event will the reduced amount for the performance bond be less than 50% of the contract price.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2021-001, continued
Area: Procurement

Condition:

For one (1) of 48 purchase orders testing for procurement compliance, we noted that PNCC did not comply with its procurement policies and regulations.

PNCC had issued a request for proposal to remove the Huawei technology from its mobile core network and the United States government had offered a grant of $2.6 million to fund the cost of replacing the core network with approved technology. Two bids were received and were rejected for failure to comply with material requirements of the invitation for bids such as specifications or time of delivery and was non-responsive.

Instead of rebidding the invitation for bid in another request for proposal, management opted to negotiate with another vendor who did not participate in the initial bidding and thus not allowing open and free competitive bidding. The vendor was selected and management negotiated a contract price of $2,590,000 and executed a Master Service Agreement dated September 20, 2021 to replace its Mobile Core Network and provide telecommunications technical implementation and management services.

A performance bond in an amount equal to 10% of the contract price was not obtained and there was no written documentation on-file approving a waiver of the requirement.

Subsequent to the award of the contract and remittance of the initial payment, the OEK determined that PNCC failed to fully adhere with its procurement policies and regulations in awarding the contract. On December 9, 2021, PNCC and the vendor negotiated an Agreement Regarding Termination of Contract and Mutual Release requiring the vendor to itemize all expenses incurred in connection with the work performed up to the date of contract termination.

Cause:

Management circumvented it procurement policy and regulation in order to expedite project. There also a lack of internal control policies and procedures to monitor and provide oversight over the procurement process to ensure adherence to existing procurement policies and procedures.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2021-001, continued
Area: Procurement

Effect:

PNCC recognized a loss of $791,812 on the termination of the contract for failure to adhere to its procurement policies and procedures.

Recommendation:

We recommend that the management of PNCC strengthen its internal control policies and procedures to ensure adherence to existing procurement policies and procedures.

The procurement policy and regulations should be reviewed and updated to be aligned with Republic of Palau Procurement Law.

Auditee Response and Corrective Action Plan:

Management is in agreement with the findings of the internal audit report, which has highlighted a procurement issue related to the termination of the contract with Blue Arcus for the installation of a new Mobile Core Network.

It is acknowledged that the management at the time circumvented the procurement policy and regulation in order to expedite the project, resulting in a loss of $791,812 and failure to adhere to procurement policies and procedures.

The senior management ultimately responsible for this procurement issue, have been exited from the business. Under new management, strict adherence to the procurement policy is being enforced, and we have already taken several steps to address the concerns raised in the audit report, including:

- Conducting a review of our procurement policies and procedures to ensure they are up-to-date, comprehensive, and aligned with Republic of Palau Procurement Law.
- Sharing of the Procurement Policy with the current Board of Directors for their input, oversight and good governance.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2021-001, continued
Area: Procurement

Auditee Response and Corrective Action Plan: continued

With significant capital investment projects in the coming financial year (FY23), additional steps will be taken to ensure the procurement process is clear to all stakeholders and that it is strictly adhered to, including:

- Enhancing our procurement training programs for all staff involved in the procurement process to ensure they understand their responsibilities and the importance of compliance with the policy.

- Implementing regular monitoring and reporting mechanisms to ensure compliance with the procurement policy and to identify and address any potential issues in a timely manner.

- Obtaining performance bonds as required by the procurement policy and regulation.

- Hiring of an additional qualified accountant who will, among other duties, support the procurement team with compliance audits and stock counts.

Management understands that maintaining strong internal controls and ensuring compliance with policies is critical to our organization's success, and we are resolutely committed to ensuring that we maintain the highest standards in our procurement practices.

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

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

Year Ended December 31, 2021

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

To the 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, 2021, and the related statement 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 February 3, 2023. In accordance with *Government Auditing Standards*, we have also issued our report dated February 3, 2023, 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 February 3, 2023 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;
- 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;

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- 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 that 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 accordance with 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, 2021, 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 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
February 3, 2023

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

Summary Schedule of Prior Year Comments
Year Ended December 31, 2021

STATUS OF PRIOR YEAR FINDINGS RESULTS

Finding No. 2020-01: Corrective action has been taken and is considered resolved.

Finding No. 2020-02: Corrective action has been taken and is considered resolved.