

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT

Years Ended December 31, 2022 and 2021

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

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December 31, 2022 and 2021

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Palau National Communications Corporation

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Palau National Communications Corporation (PNCC), a public corporation and a component unit of the Republic of Palau, as of and for the years December 31, 2022 and 2021, and the related notes to the financial statements, which collectively comprise PNCC's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of PNCC at December 31, 2022 and 2021 and the changes in financial position and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of PNCC and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about PNCC's ability to continue as a going concern for 12 months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

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Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 PNCC's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about PNCC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

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 Proportional Share of the Net Pension Liability on page 59, and the Schedule of Pension Contributions on page 60, 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 57 and 58 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 May 31, 2024 on our consideration of PNCC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of PNCC's 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 PNCC's internal control over financial reporting and compliance.



Koror, Republic of Palau
May 31, 2024

PALAU NATIONAL COMMUNICATIONS CORPORATION

(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis

December 31, 2022

Introduction

This section presents the financial analysis of Palau National Communications Corporation's (PNCC) performance for the fiscal year ended December 31, 2022. It also includes a comparison with the prior years ended December 31, 2021, and 2020.

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 2% increase in 2022, with a 4% increase in Postpaid and 2% increase in Prepaid services, respectively. Since 2018, mobile subscribers had steadily increased, but in 2020 as a result of the COVID-19 pandemic, the number of subscriptions declined. From 2021 to 2022, 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 Telephone business saw a net decrease in the number of subscriptions by 0.2%, with a 1.1 % decrease in Business/Government sectors overshadowing a 0.3% increase in Residential subscriptions.

Internet subscriptions increased by 7% YoY driven by HomeNet services. This gradual growth trend which has persisted since 2018 is expected to continue through 2023 and sharply accelerate in 2024 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 17%, with a 20% decrease in Residential subscriptions. This trend of decline is in-line with global trends for linear TV service driven by the pressure from Over-the-Top (OTT) and Video-On-Demand (VOD) services such as Netflix and Hulu. This trend is expected to slow in 2023 and stabilize in 2024 as the FTTP rollout enables IPTV which will deliver a significantly improved quality of service.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Management's Discussion and Analysis
December 31, 2022

Table 1. Subscribers 5 Year Trend

Subscribers	2018	2019	2020	2021	2022	YoY	Variance
GSM Mobile	26,524	32,868	26,359	27,335	27,929	594	2.2%
<i>Postpaid</i>	3,123	3,914	4,742	5,079	5,265	186	3.7%
<i>Prepaid</i>	23,401	28,954	21,617	22,256	22,664	408	1.8%
Fixed Line (Telephone)	7,166	6,801	6,179	6,165	6,154	-11	-0.2%
<i>Business/Government</i>	3,047	2,897	2,214	2,161	2,138	-23	-1.1%
<i>Residential</i>	4,119	3,904	3,964	4,004	4,016	12	0.3%
Internet	3,619	3,901	4,211	4,382	4,684	302	6.9%
<i>Palaunet</i>	1,302	1,086	944	844	775	-69	-8.2%
<i>DSL</i>	309	364	390	427	534	107	25.1%
<i>Domestic Leased Line/VLAN</i>	62	31	26	23	24	1	4.3%
<i>Wi-Fi Hotspots</i>	214	237	242	244	236	-8	-3.3%
<i>Homenet</i>	1,732	2,183	2,604	2,822	3,076	254	9.0%
<i>Premium WiFi</i>	-	-	5	22	37	15	68.2%
Digital TV	3,786	3,370	2,743	2,474	2,048	-426	-17.2%
<i>Single Dwelling</i>	2,939	2,623	2,377	2,103	1,687	-416	-19.8%
<i>Multi Units</i>	847	747	366	371	361	-10	-2.7%

Financial Highlights

At the end of 2022, total current assets increased by \$0.18m or 6% Year-on-Year. At the same time total assets decreased by \$1.9m or 7% Year-on-Year, mainly driven by depreciation leading to a \$2.51m or 13% reduction in Plant and Equipment.

The increase in total liability reflects the \$2.8m and \$0.72m under notes payable and accounts payable respectively. However, PNCC managed to reduce other liabilities, including a decrease of 59% in accrued expenses, and 9% in customer deposits.

In 2021, the negative net income of \$2.85m increased the negative net position to \$4.5m. In 2022, the negative net income of \$2.75m further increased the negative net position to \$7.7m at the end of the year.

In compliance with GASB Statements No.67 and No.68, \$13.6 million in 2021 and \$13.6 million in 2022 Pension Liability resulted in a cumulative deficit of -\$7.7m at the end of 2022 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, 2022

Statements of Net Position
Years ended December 31, 2022, 2021, and 2020

Assets and Deferred Outflows of Resources	2022	2021	2020
Current Assets			
Cash	\$ 471,581	\$ 345,678	\$ 465,082
Restricted cash and cash equivalents	753,734	250,171	250,146
Receivables, net	954,970	1,718,117	1,336,291
Inventories	719,871	626,488	523,710
Prepaid Expenses	418,961	193,874	302,368
Total current assets	3,319,117	3,134,328	2,877,597
Investments	1,977,456	2,353,857	2,712,124
Other noncurrent assets	54,300	54,300	54,300
Plant and equipment, net	17,031,370	19,544,319	21,205,813
Right-of-Use Assets, net	767,969	-	-
Total assets	23,150,212	25,086,804	26,849,834
Deferred Outflows of Resources - Pension	4,686,869	4,686,869	4,284,465
Total Assets and Deferred Outflow of Resources	\$ 27,837,081	\$ 29,773,673	\$ 31,134,299
 Liabilities, Deferred Inflows of Resources and Net Position			
Current Liabilities			
Current Portion of Long Term Debt	\$ 777,960	\$ 4,013,777	\$ 2,357,943
Current Portion of Lease Liability	120,762	-	-
Account Payable	1,291,066	575,419	1,610,170
Payable to carriers, net	60,615	38,111	13,566
Accrued expenses	115,494	281,525	401,735
Unearned revenues	1,619,816	1,347,717	-
Customers Deposits	442,485	485,171	570,197
Total current liabilities	4,428,197	6,741,720	4,953,611
Note Payable, net of current portion	15,386,944	12,557,081	14,235,792
Lease Liability	708,893	-	-
Net pension liability	13,660,411	13,660,411	11,837,827
Total liabilities	34,184,445	32,959,212	31,027,230
Deferred Inflows of Resources from Pension	1,331,405	1,331,405	1,775,894
Net Position:			
Net Investment in capital assets	866,466	2,973,462	4,612,078
Restricted for Debt Service and Reserve	753,734	250,171	250,146
Unrestricted	(9,298,969)	(7,740,576)	(6,531,049)
Total net position	(7,678,769)	(4,516,944)	(1,668,825)
Total Liabilities, Deferred Inflows Resources and Net Position	\$ 27,837,081	\$ 29,773,673	\$ 31,134,299

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Management's Discussion and Analysis
December 31, 2022

Statement of Revenues, Expenses and Changes in Net Position

Years ended December 31, 2022, 2021, and 2020

Operating Revenue increased by \$0.07k, or 0.6%, in 2022. This growth was primarily driven by a \$0.17m (6%) increase in Home Broadband (PalauNet) revenue, a \$0.13m (7.6%) increase in Local revenue, and a \$0.02m (0.35%) increase in Cellular revenue. These increases were offset by a year-on-year decrease in Digital Television revenue of \$0.17m or -15.32%, a continuation of the trend of decline in this revenue line from 2021. In order to sustain the revenue trends and reducing operating expenses, a significant focus was placed on efficiency and cost control in the business resulting in a decrease of \$0.22m or 1.6%. Cost reduction initiatives effectively delivered reductions in Plant Non-Specific Operations, Corporate Operations, and Customer Service Operations to offset the higher costs of energy.

With the cost reductions, the operating loss from operations decreased by \$0.30m or 15.6% from -\$1.94m in 2021 to -\$1.64m in 2022.

Table 2. Change in Net Position US\$m

Change in Net Position US\$m	2020	2021	2022	Variance	Var. %
Operating revenues	\$ 12.27	\$ 11.65	\$ 11.72	\$ 0.07	0.6%
Operating expenses	\$ (13.54)	\$ (13.59)	\$ (13.37)	\$ 0.22	-1.6%
Operating income	\$ (1.27)	\$ (1.94)	\$ (1.64)	\$ 0.30	-15.6%
Non-operating income (expenses)	\$ (0.24)	\$ (0.91)	\$ (1.11)	\$ (0.20)	22.0%
Change in net position	\$ (1.52)	\$ (2.85)	\$ (2.75)	\$ 0.10	-3.5%

Table 3. Revenue by Source US\$m

Revenue Source US\$m	2020	2021	2022	Variance	Var. %
Cellular	\$ 6.19	\$ 5.74	\$ 5.76	\$ 0.02	0.3%
Long Distance	\$ (0.02)	\$ (0.09)	\$ (0.05)	\$ 0.04	44.4%
Palaunet	\$ 3.13	\$ 2.93	\$ 3.10	\$ 0.17	5.8%
Local	\$ 1.70	\$ 1.79	\$ 1.92	\$ 0.13	7.3%
Digital Television	\$ 1.23	\$ 1.11	\$ 0.94	\$ (0.17)	-15.3%
Miscellaneous	\$ 0.14	\$ 0.16	\$ 0.25	\$ 0.09	56.3%
Provision for doubtful accounts	\$ (0.10)	\$ -	\$ (0.20)	\$ (0.20)	
Total	\$ 12.27	\$ 11.65	\$ 11.72	\$ 0.07	0.6%

PNCC's revenue is on the path to recovery, especially after the economic challenges brought about by COVID-19. The return of foreign laborers, the reopening of Palau's borders, and the revival of tourism-related activities are all key factors in boosting revenue generation. These developments indicate a gradual restoration of economic activity, which is crucial for the recovery and growth of PNCC.

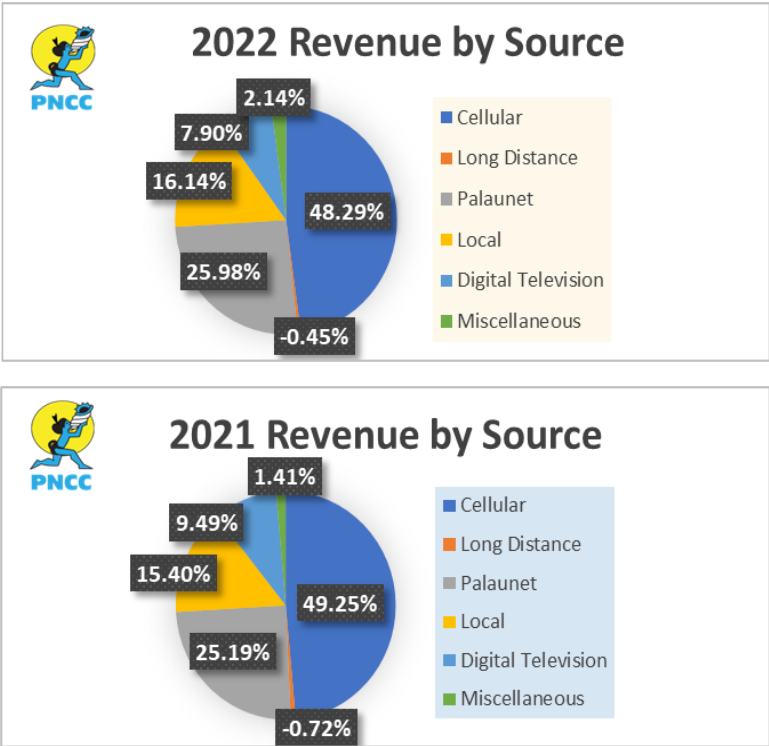
PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Management’s Discussion and Analysis
December 31, 2022

However, the expectations for economic recovery and the gradual easing of restrictions are promising for PNCC’s cellular business. The pandemic driven reduction in tourism has compounded the ongoing decline in Long Distance Revenue since 2019 from \$186,416 to \$(53,958) in 2022. The increase of OTT Voice and Messaging applications like WhatsApp and Facebook Messenger has further impacted this revenue stream.

Changes in customer preferences favoring OTT Video-On-Demand (VOD) services such as Netflix, Hulu, and Youtube have led to a reduction in DTV revenue. Despite economic challenges, Local revenue showed modest growth in 2022 of 7.6%, driven partly by new homeowners subscribing to PNCC’s Fixed Broadband services.

Chart 1. Revenue by Source 2021 and 2022 Comparison

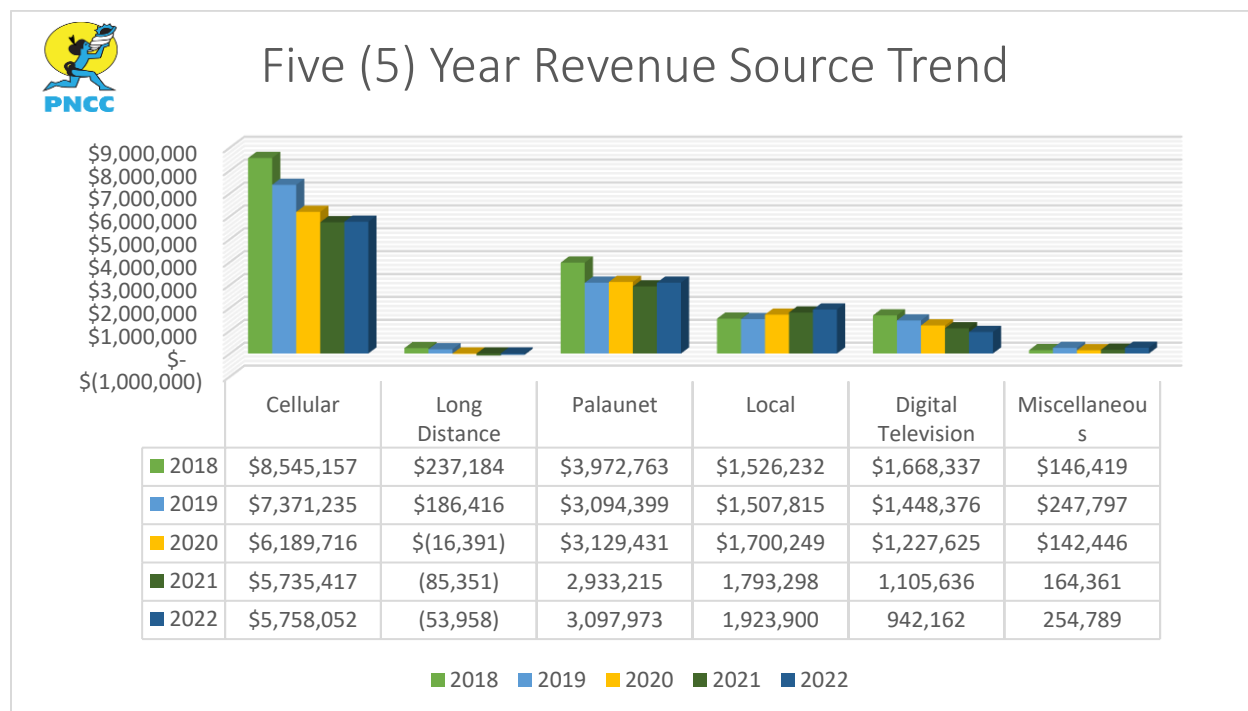


The summarized chart shows the major revenue sources where the cellular operations contributed 48% of the total revenue in 2022. While this was a slight decrease Year-on-Year of 1% Cellular remains the dominant revenue source in the business and will be the focus of revenue recovery in 2023 and the source of revenue growth in 2024.

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Management’s Discussion and Analysis
December 31, 2022

Chart 2. Revenue by Source 5 Year Trend



The five-year revenue trend reveals the performance of various revenue streams. Despite the economic challenges that impacted PNCC revenue generation, the company has continued to maintain and upgrade its infrastructure to meet customer communication needs. In 2022, Cellular revenue began to recover, increasing by 0.4%, stopping the trend of decline that started in 2019. While Long Distance revenue has continued to decline, customers are increasingly using data for real-time communication, contributing to the stabilization of Cellular Revenue YoY and a 6% increase in Palaunet revenue in 2022. Additionally, local revenue grew by 7% in 2022, driven by rising demand for fixed-line services from new homeowners and businesses since 2018. With economic recovery, growing tourism, and increased military activities and projects, PNCC expects to generate higher revenues in the coming years.

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.

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Management's Discussion and Analysis
December 31, 2022

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.

A significant milestone in enabling PNCC's strategic plans is the award of a \$35 million grant from the RUS ReConnect III program, granted on October 28, 2022. This funding will support the rollout of fiber to all premises from Kayangel to Angaur in Palau, significantly enhancing connectivity across the nation. The fiber rollout will provide high-speed internet access to all residents and businesses, enabling improved digital services and supporting economic growth.

To achieve our strategic objective of improving Mobile Data capacity and coverage PNCC is actively exploring the modernization of our mobile network to bring 5G technology to Palau, leveraging the latest advancements to enhance connectivity and service quality. In alignment with this vision, we are considering the utilization of Open Radio Access Network (O-RAN) principles to deliver this network upgrade in a cost-effective and efficient manner. This approach will enable us to deploy a more flexible, interoperable, and scalable network infrastructure.

Management is also pursuing additional funding options with international partners to supplement the \$2.6 million grant already received from the US Department of the Interior. This grant is designated for the replacement of PNCC's mobile core network with secure and trusted hardware, a critical step towards ensuring the robustness and security of our network. By combining these resources, we aim to accelerate our 5G rollout and position Palau at the forefront of telecommunications innovation in the region.

Looking ahead to 2023, PNCC anticipates the launch of new products that will meet the evolving needs of its customer base and create incremental revenue opportunities as the COVID-19 pandemic period concludes and economic activity increases.

CONTACTING PNCC'S FINANCIAL MANAGEMENT

In conclusion, the Management's Discussion and Analysis for the year ended December 31, 2022, 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 rmarui@pnccpalau.com or call 587-9000.

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

FINANCIAL SECTION

Years Ended December 31, 2022 and 2021

PALAU NATIONAL COMMUNICATIONS CORPORATION

(A Component Unit of the Republic of Palau)

Statements of Net Position
December 31, 2022 and 2021

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	<u>2022</u>	<u>2021</u>
Current assets:		
Cash	\$ 471,581	\$ 345,678
Receivables:		
Trade	1,594,418	1,774,876
Related party	755,139	594,432
Carriers, net	175,668	208,313
Other receivable	(9,397)	503,188
Allowance for doubtful accounts	<u>(1,560,858)</u>	<u>(1,362,692)</u>
Total receivables, net	954,970	1,718,117
Inventories, net	719,871	626,488
Prepaid expenses	<u>418,961</u>	<u>193,874</u>
Total current assets	2,565,383	2,884,157
Investments	1,977,456	2,353,857
Restricted cash and cash equivalents	753,734	250,171
Other noncurrent assets	54,300	54,300
Capital assets, net	17,031,370	19,544,319
Right of Use asset, net	<u>767,969</u>	<u>-</u>
Total assets	<u>23,150,212</u>	<u>25,086,804</u>
Deferred outflows of resources:		
Deferred outflows from pension	<u>4,686,869</u>	<u>4,686,869</u>
Total assets and deferred outflows of resources	<u>\$ 27,837,081</u>	<u>\$ 29,773,673</u>

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

Current liabilities:		
Current portion of long-term debt	\$ 777,960	\$ 4,013,777
Current portion of lease liability	120,762	-
Accounts payable	1,291,066	575,419
Payable to carriers, net	60,615	38,111
Accrued expenses	115,494	281,525
Unearned revenues	1,619,816	1,347,717
Customer deposits	<u>442,485</u>	<u>485,171</u>
Total current liabilities	4,428,197	6,741,720
Note payable, net of current portion	15,386,944	12,557,081
Lease liability	708,893	-
Net pension liability	<u>13,660,411</u>	<u>13,660,411</u>
Total liabilities	<u>34,184,445</u>	<u>32,959,212</u>
Deferred inflows of resources:		
Deferred inflows from pension	<u>1,331,405</u>	<u>1,331,405</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	866,466	2,973,461
Restricted for:		
Debt service and reserve	250,446	250,171
Unrestricted	<u>(8,795,681)</u>	<u>(7,740,576)</u>
Total net position	<u>(7,678,769)</u>	<u>(4,516,944)</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 27,837,081</u>	<u>\$ 29,773,673</u>

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, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Operating revenues:		
Cellular	\$ 5,758,052	\$ 5,735,417
Palaunet	3,097,973	2,933,215
Local	1,923,900	1,793,298
Digital television	942,162	1,105,636
Long distance	(53,958)	(85,351)
Miscellaneous	254,789	164,362
Provision for doubtful accounts	<u>(198,166)</u>	<u>-</u>
Total net operating revenues	<u>11,724,752</u>	<u>11,646,577</u>
Operating expenses:		
Plant specific:		
Operations	6,273,367	5,852,623
Depreciation	3,009,715	3,007,025
Corporate office	2,472,622	2,427,161
Customer service	1,139,227	1,544,352
Plant non-specific operations	<u>473,572</u>	<u>758,337</u>
Total operating expenses	<u>13,368,503</u>	<u>13,589,498</u>
Operating income loss	<u>(1,643,751)</u>	<u>(1,942,921)</u>
Nonoperating income (expense):		
Unrealized gain (loss) on investments	(338,710)	331,028
Grant Revenue	-	427,283
Income on investments	-	8,115
Contract termination costs	-	(791,812)
Other income (expense), net	(117,082)	(118,786)
Interest expense	<u>(652,358)</u>	<u>(761,026)</u>
Total nonoperating income (expense), net	<u>(1,108,150)</u>	<u>(905,198)</u>
Change in net position	(2,751,901)	(2,848,119)
Net position (deficit) at beginning of year	(4,516,944)	(1,668,825)
Adjustment for right-of-use asset	<u>(409,924)</u>	<u>-</u>
Adjusted net position (deficit) at beginning of year	<u>(4,926,868)</u>	<u>(1,668,825)</u>
Net position (deficit) at end of year	<u>\$ (7,678,769)</u>	<u>\$ (4,516,944)</u>

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, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities:		
Cash received from customers	\$ 12,487,899	\$ 12,017,851
Cash payments to suppliers for goods and services	(6,260,267)	(9,628,436)
Cash payments to employees	<u>(3,629,162)</u>	<u>(1,361,168)</u>
Net cash provided by operating activities	<u>2,598,470</u>	<u>1,028,247</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(753,504)	(2,209,153)
Additions from restricted cash and cash equivalents	(503,563)	(25)
Capital grant funds received	272,099	1,775,000
Interest paid	(625,853)	(761,026)
Repayment of long-term debt	<u>(405,954)</u>	<u>(22,877)</u>
Net cash used in financing activities	<u>(2,016,775)</u>	<u>(1,218,081)</u>
Cash flows from investing activities:		
Other income (expense), net	(117,082)	(118,786)
Unrealized gain (loss) on investments	(338,710)	331,028
Proceeds from sale and maturities of investment securities	-	700,000
Loss on contract termination	-	(791,812)
Purchase of investment securities	<u>-</u>	<u>(50,000)</u>
Net cash used in investing activities	<u>(455,792)</u>	<u>70,430</u>
Net change in cash	125,903	(119,404)
Cash at beginning of year	<u>345,678</u>	<u>465,082</u>
Cash at end of year	<u>\$ 471,581</u>	<u>\$ 345,678</u>

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, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (1,643,751)	\$ (1,942,921)
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation and amortization	3,009,715	3,007,025
Pension cost	-	975,691
Unrealized gain (loss) on investments	338,710	(331,028)
Provision for doubtful accounts	198,166	-
Other income (expense), net	117,082	118,786
Right of use adjustment to net position	(409,924)	
Realized gain on investments	-	(427,283)
Income on investments	-	(8,115)
(Increase) decrease in assets:		
Receivables:		
Trade	180,458	63,940
Related party	(160,707)	(203,220)
Carriers, net	32,645	140,569
Other receivable	512,585	(503,188)
Inventories	(93,383)	(102,778)
Prepaid expenses	(225,087)	108,494
Right of use assets	(889,227)	-
Increase (decrease) in liabilities:		
Accounts payable	715,647	(1,034,751)
Payable to carriers, net	22,504	24,545
Accrued expenses	(166,031)	(120,210)
Customer deposits	(42,686)	(85,026)
Lease liability	829,655	-
Unearned revenues	272,099	1,347,717
Net cash provided by operating activities	<u>\$ 2,598,470</u>	<u>\$ 1,028,247</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
December 31, 2022 and 2021

(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.

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

Notes to Financial Statements
December 31, 2022 and 2021

(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, 2022 and 2021, 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, 2022 and 2021, PNCC have deferred outflows of resources and deferred inflows of resources that was included as a component of restricted net position.

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

Notes to Financial Statements
December 31, 2022 and 2021

(2) Summary of Significant Accounting Policies, continued

A. Basis of Presentation, continued

PNCC's component of net position, continued

Restricted net position, continued

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

Nonexpendable: Net position subject to externally imposed stipulations that require PNCC to maintain them permanently. At December 31, 2022 and 2021, 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, 2022 and 2021, 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.

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

Notes to Financial Statements
December 31, 2022 and 2021

(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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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 2022 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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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, 2022 and 2021 is as follows:

	<u>2022</u>	<u>2021</u>
Balance at beginning of the year	\$ 1,362,692	\$ 1,242,217
Current year provision	<u>198,166</u>	<u>120,475</u>
Balance at end of year	<u>\$ 1,560,858</u>	<u>\$ 1,362,692</u>

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, 2022 and 2021, 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, 2022 and 2021 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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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:

	<u>Estimated Useful Lives</u>
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, 2022 and 2021.

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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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, 2022 and 2021, 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, 2022 and 2021 accrued annual leave totaled \$145,441 and \$64,746, respectively, and is included in the Statements of Net Position as a component of accrued expenses. At December 31, 2022 and 2021, all compensated absences are current. For the years ended December 31, 2022 and 2021, annual vacation leave taken totaled \$204,375 and \$167,835, 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 \$0 and \$427,283 as grant revenues as of December 31, 2022 and 2021, respectively. Unearned revenues totaled \$1,619,816 and \$1,347,717 which represents the grant revenue not yet earned or realized, and classified as a liability as of December 31, 2022 and 2021, respectively.

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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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, 2022 and 2021, customer deposits totaled \$442,485 and \$485,171, respectively.

Advertising Costs

Advertising costs are expensed as incurred. For years ended December 31, 2022 and 2021, advertising costs totaled \$35,975 and \$22,143, 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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(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, 2022, PNCC's net position is a negative \$7,678,681, meaning that total liabilities exceeded total assets. Net position consists of three components: net investment in capital assets net of related debt; restricted - expendable and nonexpendable; and unrestricted. Net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of the related debt. Net position is reported as restricted when constraints are imposed by third parties or enabling legislation. At December 31, 2022, PNCC had a negative change in net position totaling \$2,751,901.

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

In 2020, GASB issued Statement No. 95 *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postponed the effective dates of GASB Statement No. 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 each pronouncement as originally issued. In accordance with GASB Statement No. 95, management had elected the implementation of these statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

During the year ended September 30, 2022, PNCC implemented the following pronouncements:

In June 2017, GASB issued Statement No. 87, Leases. This Statement aims to better meet the information needs of financial statement users by improving 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 recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

The Company has elected the short-term lease recognition exemption for all applicable classes of underlying assets. Leases with an initial term of 12 months or less, that do not include an option to purchase the underlying asset that we are reasonably certain to exercise, are not recorded on the balance sheet.

As a result of adopting the new standards effective January 01, 2022, the Company reclassified \$400,000 from capital assets to leased assets and recorded additional net lease assets and lease liabilities of approximately \$889,227 and \$899,151, respectively. The difference between the lease assets and lease liabilities was recorded as an approximate \$409,924 reduction to beginning net position.

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.

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(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

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.

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. The implementation of this Statement did have a material effect on the financial statements.

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 evaluation of the effectiveness of derivative instruments. The implementation of this Statement did have a material effect on the financial statements.

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. The implementation of this Statement did have a material effect on the financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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(2) Summary of Significant Accounting Policies, continued

F. New Accounting Standards, continued

GASB 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. The implementation of this Statement did have a material effect on the financial statements.

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. The implementation of this Statement did have a material effect on the financial statements.

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(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, 2022 and 2021, the carrying amount of PNCC's cash balances was \$471,581 and \$345,678, respectively. The corresponding bank balances as of December 31, 2022 and 2021 were \$497,652 and \$365,298, respectively. From these deposits, \$434,402 and \$342,128, 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.

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(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:

Investments by fair value level	12/31/2022	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
Fixed income securities:				
Corporate Bonds	\$ 345,102	\$ -	\$ 345,102	\$ -
U.S. Treasury	334,800	334,800	-	-
Equity securities:				
U.S. Equities	893,146	893,146	-	-
Non-U.S. Equities	<u>161,159</u>	<u>161,159</u>	<u>-</u>	<u>-</u>
Total investments by fair value level	<u>\$ 1,734,207</u>	<u>\$ 1,389,105</u>	<u>\$ 345,102</u>	<u>\$ -</u>
Investments measured at net asset value (NAV):				
Exchanged-traded funds	<u>\$ 184,852</u>			
Investments measured at cost based measure:				
Money market funds	<u>\$ 58,397</u>			
Total investments	<u>\$ 1,977,456</u>			

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(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

Investments by fair value level	12/31/2021	Fair Value Measurement Using		
		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	<u>207,105</u>	<u>207,105</u>	<u>-</u>	<u>-</u>
 Total investments by fair value level	 <u>\$ 2,254,990</u>	 <u>\$ 1,830,371</u>	 <u>\$ 424,619</u>	 <u>\$ -</u>
Investments measured at net asset value (NAV):				
Exchanged-traded funds	<u>\$ 55,433</u>			
Investments measured at cost based measure:				
Money market funds	<u>\$ 43,434</u>			
 Total investments	 <u>\$ 2,353,857</u>			

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 \$250,446, and \$250,171 as of December 31, 2022 and 2021, respectively, were deposited in FDIC insured financial institutions.

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(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.

At December 31, 2022 and 2021, PNCC's investment portfolios at fair value are as follows:

	2022			2021		
	Allocation		Market Value	Allocation		Market Value
	Actual	Policy		Actual	Policy	
Fixed income securities:						
Corporate Bonds			\$ 345,102			\$ 424,619
U.S. Treasury			334,800			390,457
Federal Agencies			-			-
Total fixed income	35%	36%	679,902	35%	36%	815,076
Equity securities:						
U.S. Equities	45%	43%	893,146	52%	43%	1,232,809
Non-U.S. Equities	8%	19%	<u>161,158</u>	9%	19%	<u>207,105</u>
Total equity securities			1,054,304			1,439,914
Exchange-traded funds	9%	1%	184,852	2%	1%	55,433
Cash and cash equivalents	<u>3%</u>	<u>1%</u>	<u>56,992</u>	<u>2%</u>	<u>1%</u>	<u>43,434</u>
Total investments	<u>100%</u>	<u>100%</u>	\$ <u>1,976,050</u>	<u>100%</u>	<u>100%</u>	\$ <u>2,353,857</u>

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Notes to Financial Statements
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(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

At December 31, 2022 and 2021, PNCC's fixed income securities had the following ratings and maturities:

<u>Investment type</u>	<u>Fair Value</u>	As of December 31, 2022				Rating	
		Investment maturities (in years)				Moody	Standard & Poor
		Less than 1	1-5	6-10	More than 10		
Corporate bonds	\$ 21,872	\$ -	\$ -	\$ 21,872	\$ -	Baa2	BBB
Corporate bonds	19,210	-	-	-	19,210	A2	A-
Corporate bonds	21,425	-	21,425	-	-	Baa2	BBB
Corporate bonds	22,247	-	-	22,247	-	Baa2	BBB
Corporate bonds	20,205	-	-	20,205	-	Baa3	BBB
Corporate bonds	21,207	-	21,207	-	-	A3	A-
Corporate bonds	17,479	-	-	-	17,479	A3	A-
Corporate bonds	22,851	-	22,851	-	-	A3	A-
Corporate bonds	20,332	-	-	-	20,332	Baa1	BBB
Corporate bonds	20,026	-	-	-	20,026	A1	A-
Corporate bonds	20,516	-	-	20,516	-	Baa2	BBB
Corporate bonds	17,109	-	-	-	17,109	Aaa	AAA
Corporate bonds	19,899	-	-	19,899	-	Baa2	BBB
Corporate bonds	20,721	-	-	-	20,721	Baa1	BBB+
Corporate bonds	20,083	-	-	20,083	-	A3	A-
Corporate bonds	18,663	-	-	18,663	-	Baa2	BBB
Corporate bonds	21,257	-	21,257	-	-	A1	BBB+
U.S. Treasury	28,632	-	-	-	28,632	Aaa	No rating
U.S. Treasury	32,851	-	-	-	32,851	Aaa	No rating
U.S. Treasury	34,501	-	34,501	-	-	Aaa	No rating
U.S. Treasury	28,307	-	-	28,307	-	Aaa	No rating
U.S. Treasury	22,617	-	22,617	-	-	Aaa	No rating
U.S. Treasury	37,770	-	37,770	-	-	Aaa	No rating
U.S. Treasury	30,287	-	30,287	-	-	Aaa	No rating
U.S. Treasury	37,862	-	37,862	-	-	Aaa	No rating
U.S. Treasury	22,807	-	22,807	-	-	Aaa	No rating
U.S. Treasury	23,082	-	23,082	-	-	Aaa	No rating
U.S. Treasury	36,084	-	36,084	-	-	Aaa	No rating
Total	\$ 679,902	\$ -	\$ 331,750	\$ 171,792	\$ 176,360		

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Notes to Financial Statements
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(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

As of December 31, 2021

<u>Investment type</u>	<u>Fair Value</u>	<u>Investment maturities (in years)</u>				<u>Rating</u>	
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>	<u>Moody</u>	<u>Standard & Poor</u>
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		

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(4) Capital Assets

PNCC's capital assets for the years ended December 31, 2022 and 2021 are summarized below as follows:

	Balance at December 31, 2021	Additions	Transfers/ Retirements	Balance at December 31, 2022
Regulated capital assets				
Cables and transmission lines	\$ 28,474,413	\$ 88,214	\$ -	\$ 28,562,627
Transmission equipment	9,899,825	-	-	9,899,825
Buildings	10,047,275	2	-	10,047,277
Central office equipment	4,753,034	585	-	4,753,619
General support equipment	2,862,088	4,759	-	2,866,847
Customer premises wiring and equipment	1,569,727	30,488	-	1,600,215
Vehicles	850,848	50,375	-	901,223
Furniture and fixtures	<u>36,806</u>	<u>-</u>	<u>-</u>	<u>36,806</u>
Regulated capital assets, at cost	58,494,016	174,423	-	58,668,439
Accumulated depreciation	<u>(48,231,035)</u>	<u>(1,651,275)</u>	<u>-</u>	<u>(49,882,310)</u>
Regulated capital assets, at net book value	<u>10,262,981</u>	<u>(1,476,852)</u>	<u>-</u>	<u>8,786,129</u>
Non-regulated capital assets				
Cable television	3,698,478	15,911	-	3,714,389
Cellular	15,516,810	277,925	-	15,794,735
Palaunet	<u>2,381,336</u>	<u>-</u>	<u>(3)</u>	<u>2,381,333</u>
Non-regulated capital assets, at cost	21,596,624	293,836	(3)	21,890,457
Accumulated depreciation	<u>(13,453,236)</u>	<u>(1,237,183)</u>	<u>-</u>	<u>(14,690,419)</u>
Non-regulated capital assets, at net book value	<u>8,143,388</u>	<u>(943,347)</u>	<u>(3)</u>	<u>7,200,038</u>
Construction in progress	<u>1,137,950</u>	<u>403,253</u>	<u>(496,000)</u>	<u>1,045,203</u>
Total	<u>\$ 19,544,319</u>	<u>\$ (2,016,946)</u>	<u>\$ (496,003)</u>	<u>\$ 17,031,370</u>

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(4) Capital Assets, continued

	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

Depreciation expense for the years ended December 31, 2022 and 2021 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, 2022 and 2021, amounts due from the Republic of Palau and its component units totaled \$404,588 and \$573,000, respectively.

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(6) Long-term Debt

Long-term debt as of December 31, 2022 and 2021 are summarized below:

	2022	2021
Mortgage note payable to Rural Utilities Services (RUS) at 3.0% per annum, payable in monthly installments of \$104,515, and due May 2039. The note is collateralized by substantially all of PNCC's assets and a pledge of its revenues.	\$ 16,164,904	\$ 16,570,858
Less current portion	(777,960)	(4,013,777)
Long-term debt, net of current portion	\$ 15,386,944	\$ 12,557,081

RUS Mortgage Note

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

Due to the severe financial impacts caused by the COVID-19 pandemic in 2020, PNCC entered into two Deferral Agreements with RUS. The first Deferral Agreement was signed on July 31, 2020, deferring principal payments for 12 months starting July 2020, with PNCC required to make interest payments during this period. After the initial deferment period ended in July 2021, an additional deferment period was agreed upon, extending until December 31, 2021. Once the deferment period concluded, PNCC was to resume monthly principal and interest payments until maturity. The deferred principal amount would be re-amortized after the deferment period.

The negative loan covenants required PNCC to submit monthly and quarterly financial statements, monthly billing and collection reports, balances of accounts receivable and accounts payable, and the number of customers by service offering type. During the principal deferment period, PNCC was prohibited from issuing bonuses or increments to employees or officers as a result of the deferral agreement. PNCC was also restricted from using its funds to pay any debts or other amounts owed to creditors other than RUS without prior written approval from RUS. However, PNCC was allowed to make payments for work performed and materials provided in the ordinary course of business. Additionally, without the prior written consent of RUS, PNCC could not make any membership withdrawals, unit redemptions, or other profit allocations to any enterprise of the Government of Palau, nor make any dividend payments or other distributions resembling investments, guarantees, extensions of credit, loans, or advance payments on obligations.

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Notes to Financial Statements
December 31, 2022 and 2021

(6) Long-term Debt, continued

On January 20, 2022, PNCC entered into a Second Amended Deferral Agreement with RUS, deferring principal payments on the outstanding debt of the Note for 30 months, from July 31, 2020, through December 31, 2022. During this period, PNCC was required to make interest payments only. Consequently, the original Promissory Note dated May 16, 1994, in the amount of \$39,143,000, was amended on July 7, 2022, with a remaining unpaid principal balance of \$16,560,001. The amended Promissory Note reduced the interest rate from 4.59% to 3% and extended the maturity date from October 2029 to May 2039. All other deferment covenants, as outlined previously, remained applicable to the Second Amended Deferral Agreement. Beginning July 31, 2022, PNCC resumed making monthly principal and interest payments on the Note.

The management of PNCC believes it is in compliance with the RUS mortgage loan covenants at December 31, 2022 and 2021.

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

Years Ending December 31,	Principal	Interest	Total
2023	\$ 777,960	\$ 476,224	\$ 1,254,184
2024	801,504	452,680	1,254,184
2025	826,082	428,102	1,254,184
2026	851,127	403,057	1,254,184
2027	877,015	377,169	1,254,184
2028-2032	4,801,682	1,445,540	6,247,222
2033-2037	5,577,842	693,081	6,270,923
2028-2039	1,651,692	38,231	1,689,923
	<u>\$ 16,164,904</u>	<u>\$ 4,314,084</u>	<u>\$ 20,478,988</u>

Interest expense paid in 2022 and 2021 amounted to \$652,358 and \$7761,026, respectively.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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December 31, 2022 and 2021

(6) Long-term Debt, continued

At December 31, 2022 and 2021, the changes in the long-term liabilities are as follows:

	Balance January 1,			Balance December 31,		
	2022	Additions	Reductions	2022	Current	Noncurrent
Rural Utilities Services	\$ 16,570,858	\$ -	\$ 405,954	\$ 16,164,904	\$ 777,960	\$ 15,386,944
Lease liability	-	829,655	-	829,655	120,762	708,893
Net Pension Liability	13,660,411	1,822,584	-	15,482,995	-	15,482,995
	<u>\$ 30,231,269</u>	<u>\$ 2,652,239</u>	<u>\$ 405,954</u>	<u>\$ 32,477,554</u>	<u>\$ 898,722</u>	<u>\$ 31,578,832</u>

	Balance January 1,			Balance December 31,		
	2021	Additions	Reductions	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
	<u>\$ 28,431,562</u>	<u>\$ 1,822,584</u>	<u>\$ 22,877</u>	<u>\$ 30,231,269</u>	<u>\$ 4,013,777</u>	<u>\$ 26,217,492</u>

(7) Leasing Arrangements

The entity leases a building and its premises for office space and general operations. The entity entered into a 5-year lease on May 24, 2019, with an option to extend for another 5 years. The lease payments are \$200,000 for each of the first two years, payable annually. And \$12,000 per month, payable at the beginning of every month thereafter.

The following summarizes the line items in the financial statements which include amounts for operating leases for the year ended December 31, 2022:

Right-of-use assets	<u>\$ 767,969</u>
Lease liabilities:	
Current	\$ 120,762
Non-current	708,893
	<u>\$ 829,655</u>
Operating lease expense:	
Amortization of right-of-use assets	\$ 121,258
Interest on operating lease liabilities	26,504
	<u>\$ 147,762</u>

Cash paid for amounts included in the measurement of lease liabilities totaled \$96,000.

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(7) Leasing Arrangements, continued

The following is a schedule of future minimum lease payments, that are due for each of the next five years and thereafter, as follows:

Year ending December 31,	Total
2023	\$ 144,000
2024	144,000
2025	144,000
2026	144,000
2027	144,000
2028 - 2029	192,000
Total maturities of lease payments	\$ 912,000
Less: Imputed interest	(82,345)
Present value of lease liabilities	\$ 829,655

The Company uses its incremental borrowing rate of 3%, based on the information available at the commencement date, in determining the present value of lease payments.

(8) 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 Fund 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. The most recent actuarial study conducted for the Fund and related report has not been issued as of the date of this report.

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December 31, 2022 and 2021

(8) Pension Plan, continued

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	<u>3480</u>
Total members	<u>6361</u>

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.

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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
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(8) Pension Plan, continued

General Information About the Pension Plan, continued:

Pension Benefits:

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 his or her designated beneficiary. Disability benefits are paid to qualified members for the duration of the disability. Effective May 17, 1996, through RPPL 4-49, members, who have twenty-five years or more of total service, are eligible for retirement regardless of their age and, upon such retirement, are eligible to receive pension benefits at a level established by the Board. Effective July 1, 1999, pursuant to RPPL 4-49 and RPPL 5-30, retirement is mandatory for all members who have thirty years or more of total service and all employees who are sixty years of age or older with certain exceptions. Beginning October 1, 2003, pursuant to RPPL 6-37, mandatory retirement may be delayed for up to five years, by specific exemption by the Board. In December 2008, RPPL 7-56 eliminated early retirement and thirty-year mandatory service provisions. These provisions were restored through RPPL 8-10 in October 2009. On April 30, 2013, RPPL 9-2 eliminated the mandatory service retirement after thirty years of service. After December 31, 2013, no employee shall be entitled to pension benefits until reaching the age of sixty.

In accordance with the directives of RPPL 5-7, 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.

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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(8) Pension Plan, continued

General Information About the Pension Plan, continued:

Pension Benefits, continued:

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

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

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

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

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

Upon 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.

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Notes to Financial Statements
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(8) Pension Plan, continued

General Information About the Pension Plan, continued:

Pension Benefits, continued:

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

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December 31, 2022 and 2021

(8) 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. Upon complete separation from service, a member with less than fifteen years membership service may elect to receive a refund of all of his or her contributions. Subsequent changes in the percentage contributed by members may be made through an amendment of the Trust Fund Operation Plan subject to the requirements of Title 6 of the Palau National Code. RPPL 9-2 requires each employee of the National Government and all State Governments, without regard to whether the employee is employed part-time or on a temporary basis, seasonal or an impermanent basis, to contribute to the Fund through payroll deduction.

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%

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

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

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

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Notes to Financial Statements
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(8) 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:

<u>Assets Class</u>	<u>Target Allocation</u>	<u>Expected Rate of Return</u>
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%
	<u>100%</u>	

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%.

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Notes to Financial Statements
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(8) 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, 2022 and 2021, 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

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(8) 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:

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

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, 2022, 2021 and 2020, PNCC’s employer’s share paid to the Social Security Administration for these costs was \$215,112, \$203,655 and \$249,210, respectively, and is included as a component of payroll burden in the Schedule of Functional Expenses.

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Notes to Financial Statements
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(9) 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	<u>(503,188)</u>
Loss on contract termination	<u>\$ 791,812</u>

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.

(10) Commitments and Contingencies

Commitments – Operating and Circuit Service Agreements

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 \$185. 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.

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.

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Notes to Financial Statements
December 31, 2022 and 2021

(10) Commitments and Contingencies, continued

Commitments – Operating and Circuit Service Agreements, continued

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 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.

Future minimum lease and service payments are as follows:

2023	\$ 55,440
2024	30,100
2025	12,000
2026	12,000
2027	<u>8,000</u>
	<u>\$ 117,540</u>

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.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(10) Commitments and Contingencies, continued

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, 2022 and 2021 was \$1,113,801 and \$1,174,025, respectively.

(11) 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, 2022 and 2021, the Company's discretionary profit-sharing contribution were \$48,472 and \$48,587, 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.

(12) 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.

(13) Reclassifications

Certain amounts presented in 2021 have been reclassified to conform to the 2022 financial statement presentation. These reclassifications did not affect the change in net position or the total net position.

PALAU NATIONAL COMMUNICATIONS CORPORATION
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Notes to Financial Statements
December 31, 2022 and 2021

(14) 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.

(15) Subsequent Event

During October 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. This funding will support the rollout of fiber to all premises from Kayangel to Angaur in Palau, significantly enhancing connectivity across the Republic of Palau. The fiber rollout will provide high-speed internet access to all residents and businesses, enabling improved digital services and supporting economic growth.

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SUPPLEMENTARY SCHEDULES

Year Ended December 31, 2022

PALAU NATIONAL COMMUNICATIONS CORPORATION

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Supplementary Information
Schedule of Budget vs Actual (GAAP Basis)
For the Year Ended December 31, 2022

	Budget			Actual	Variance
	Original	Revisions	Final		Favorable (Unfavorable)
Operating revenues:					
Cellular	\$ 6,070,796	\$ -	\$ 6,070,796	\$ 5,758,052	\$ (312,744)
Palaunet	3,280,611	-	3,280,611	3,097,973	(182,638)
Digital television	1,241,920	-	1,241,920	1,923,900	681,980
Local	1,810,074	-	1,810,074	942,162	(867,912)
Long distance	(84,524)	-	(84,524)	(53,958)	30,566
Miscellaneous	250,000	-	250,000	254,789	4,789
Provision for doubtful accounts	-	-	-	(198,166.00)	(198,166.00)
Total operating revenues	<u>12,568,877</u>	<u>-</u>	<u>12,568,877</u>	<u>11,724,752</u>	<u>(844,125)</u>
Operating expenses:					
Plant specific operations	5,309,036	-	5,309,036	6,273,367	(964,331)
Depreciation	2,064,761	-	2,064,761	3,009,715	(944,954)
Customer service operations	1,355,896	-	1,355,896	2,472,622	(1,116,726)
Corporate operations	1,949,285	-	1,949,285	1,139,227	810,058
Plant non-specific operations	<u>929,886</u>	<u>-</u>	<u>929,886</u>	<u>473,572</u>	<u>456,314</u>
Total operating expenses	<u>11,608,864</u>	<u>-</u>	<u>11,608,864</u>	<u>13,368,503</u>	<u>(1,759,639)</u>
Operating income	<u>960,013</u>	<u>-</u>	<u>960,013</u>	<u>(1,643,751)</u>	<u>(2,603,764)</u>
Non-operating income (expenses):					
Interest expense	(770,106)	-	(770,106)	(652,358)	117,748
Unrealized gain (loss) on investment	(46,696)	-	(46,696)	(338,710)	(292,014)
Realized gain on investments	575,965	-	575,965	-	(575,965)
Other expense	<u>(3,650)</u>	<u>-</u>	<u>(3,650)</u>	<u>(117,082)</u>	<u>(113,432)</u>
Total nonoperating expenses, net	<u>(244,487)</u>	<u>-</u>	<u>(244,487)</u>	<u>(1,108,150)</u>	<u>(863,663)</u>
Change in net position	<u>\$ 715,526</u>	<u>\$ -</u>	<u>\$ 715,526</u>	<u>\$ (2,751,901)</u>	<u>\$ (3,467,427)</u>

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, 2022
(With Comparative Totals for 2021)

	Plant Specific				Total	Plant Non-Specific Operations	Total	
	Depreciation	Operations	Corporate	Customer Relations			Operating Expenses 2022	2021
Outside services	\$ -	\$ 3,788,785	\$ 243,643	\$ 490,254	\$ 4,522,682	\$ 7,890	\$ 4,530,572	\$ 4,401,895
Depreciation	2,888,457	-	-	-	2,888,457	-	2,888,457	3,007,025
Lease amortization	121,258	-	-	-	121,258	-	121,258	-
Others	-	47,572	241,589	45,895	335,056	50,045	385,101	196,414
Salaries and wages	-	1,240,925	1,260,494	586,317	3,087,736	364,870	3,452,606	3,325,873
Utilities	-	902,736	-	-	902,736	-	902,736	466,418
Materials and supplies	-	120,879	1,904	1,782	124,565	16,157	140,722	233,869
Bad debts	-	-	-	-	-	-	-	120,474
Gross revenue taxes	-	-	373,576	-	373,576	-	373,576	413,921
Clearance	-	7,126	-	-	7,126	122	7,248	12,084
Insurance	-	-	122,878	-	122,878	-	122,878	82,168
Legal fees	-	-	46,468	-	46,468	-	46,468	47,700
Fuel	-	26,942	18,925	2,743	48,610	24,624	73,234	92,717
Training	-	345	74,092	520	74,957	240	75,197	22,312
Office supplies	-	1,185	31,171	4,438	36,793	1,929	38,722	30,516
Postage	-	-	21,672	-	21,672	-	21,672	29,056
Payroll burden	-	136,872	24,709	7,279	168,861	7,696	176,556	1,094,105
Board fees	-	-	11,500	-	11,500	-	11,500	12,950
Rent	-	-	-	-	-	-	-	-
Allocation	-	-	-	-	-	-	-	1
	<u>\$ 3,009,715</u>	<u>\$ 6,273,367</u>	<u>\$ 2,472,622</u>	<u>\$ 1,139,227</u>	<u>\$ 12,894,931</u>	<u>\$ 473,572</u>	<u>\$ 13,368,503</u>	<u>\$ 13,589,498</u>

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, 2022
(With Comparative Totals for 2021)

					Total Operating Expenses By Division	
	Depreciation	Operations	Corporate	Customer Relations	2022	2021
Telephony:						
Outside services	\$ -	\$ 2,941,718	\$ 243,643	\$ 39,815	\$ 3,225,176	\$ 3,249,242
Depreciation	1,651,274	-	-	-	1,651,274	1,782,018
Lease amortization	121,258	-	-	-	121,258	-
Salaries and wages	-	457,936	1,260,494	583,837	2,302,267	2,223,035
Others	-	4,506	241,589	3,895	249,990	78,866
Utilities	-	902,736	-	-	902,736	466,418
Bad debts	-	-	-	-	-	120,474
Business gross revenue tax	-	-	373,576	-	373,576	413,921
Materials and supplies	-	82,187	1,904	1,782	85,873	157,492
Clearance	-	4,519	-	-	4,519	6,132
Insurance	-	-	122,878	-	122,878	82,168
Legal fees	-	-	46,468	-	46,468	47,700
Fuel	-	16,277	18,925	2,743	37,945	67,203
Office supplies	-	1,185	31,171	4,438	36,793	27,794
Postage	-	-	21,672	-	21,672	29,056
Training	-	155	74,092	520	74,767	21,618
Board fees	-	-	11,500	-	11,500	12,950
Payroll burden	-	44,743	24,709	7,279	76,732	691,206
Allocation	-	-	-	-	-	(61,761)
	<u>1,772,532</u>	<u>4,455,962</u>	<u>2,472,622</u>	<u>644,308</u>	<u>9,345,424</u>	<u>9,415,531</u>
Cellular:						
Depreciation	875,251	-	-	-	875,251	873,292
Outside services	-	1,335	-	-	1,335	6,075
Others	-	18,422	-	42,000	60,422	64,049
Materials and supplies	-	1,277	-	-	1,277	4,986
Training	-	-	-	-	-	-
Salaries and wages	-	91,646	-	-	91,646	86,780
Payroll burden	-	-	-	-	-	-
Allocation	-	-	-	-	-	29,452
	<u>875,251</u>	<u>112,680</u>	<u>-</u>	<u>42,000</u>	<u>1,029,931</u>	<u>1,064,634</u>
Palaunet:						
Outside services	-	843,465	-	-	843,465	637,485
Others	-	17,928	-	-	17,928	580
Depreciation	182,707	-	-	-	182,707	179,209
Training	-	60	-	-	60	120
Materials and supplies	-	188	-	-	188	3,384
Salaries and wages	-	208,400	-	-	208,400	182,581
Payroll burden	-	92,153	-	-	92,153	75,053
Clearance	-	604	-	-	604	1,208
Fuel	-	-	-	-	-	-
Allocation	-	-	-	-	-	20,970
	<u>182,707</u>	<u>1,162,796</u>	<u>-</u>	<u>-</u>	<u>1,345,503</u>	<u>1,100,590</u>
Digital TV:						
Outside services	-	2,267	-	450,439	452,706	505,490
Materials and supplies	-	37,227	-	-	37,227	37,266
Depreciation	179,225	-	-	-	179,225	172,507
Others	-	6,716	-	-	6,716	11,598
Fuel	-	10,665	-	-	10,665	17,500
Training	-	130	-	-	130	167
Office supplies	-	-	-	-	-	442
Clearance	-	2,004	-	-	2,004	3,122
Salaries and wages	-	482,943	-	2,480	485,423	490,554
Payroll burden	-	(24)	-	-	(24)	420
Allocation	-	-	-	-	-	11,340
	<u>179,225</u>	<u>541,929</u>	<u>-</u>	<u>452,919</u>	<u>1,174,072</u>	<u>1,250,406</u>
	<u>\$ 3,009,715</u>	<u>\$ 6,273,367</u>	<u>\$ 2,472,622</u>	<u>\$ 1,139,227</u>	<u>\$ 12,894,931</u>	<u>\$ 12,831,161</u>

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 percentage 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*

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
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	<u>145,962</u>	<u>137,597</u>	<u>122,246</u>	<u>114,435</u>	<u>100,271</u>	<u>94,083</u>	<u>97,071</u>
Contribution (excess) deficiency	<u>\$ 478,971</u>	<u>\$ 403,133</u>	<u>\$ 478,999</u>	<u>\$ 451,112</u>	<u>\$ 360,971</u>	<u>\$ 260,704</u>	<u>\$ 275,442</u>
PNCC's covered-employee payroll**	<u>\$ 2,432,700</u>	<u>\$ 2,293,283</u>	<u>\$ 2,037,433</u>	<u>\$ 1,907,250</u>	<u>\$ 1,694,398</u>	<u>\$ 1,578,557</u>	<u>\$ 1,648,460</u>
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.

See accompanying independent auditor's report.

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

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

Years Ended September 30, 2022 and 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*

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), which comprise the statement of net position as of September 30, 2022 and 2021, and the related statements of revenues, expenses and changes in net position and the statement of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 31, 2024.

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

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 determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the 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.



Koror, Republic of Palau
May 31, 2024

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

Schedule of Findings and Responses
Year Ended December 31, 2022

SECTION I – SUMMARY OF AUDITORS’ RESULTS

Financial Statements

Type of auditor’s report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? _____yes X no

- Significant deficiency(ies) identified that are not considered to be material weaknesses? _____yes X no

- Noncompliance material to financial statements? _____yes X no

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, 2022



**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;

- 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, 2022, 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.



Koror, Republic of Palau
May 31, 2024

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

Summary Schedule of Prior Year Comments
Year Ended December 31, 2022

STATUS OF PRIOR YEAR FINDINGS RESULTS

Finding No. 2021-001: Corrective action has been taken and is considered resolved.